No. 10936

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE S. GAYLORD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

GERTRUDE H. GAYLORD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' OPENING BRIEF.

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PETITIONERS' OPENING BRIEF.

To the Honorable United States Circuit Court of Appeals for the Ninth Circuit and the Judges Thereof:

Jurisdiction of This Court to Review Decision in Question

These are proceedings for review by the United States Circuit Court of Appeals for the Ninth Circuit of a decision of the Tax Court of the United States (hereinafter called Tax Court) entered August 4, 1944, determining against petitioner George S. Gaylord (hereinafter called Mr. Gaylord) certain deficiencies in his income taxes for the taxable years 1936, 1937, 1938 and 1939 [Transcript of the Record—hereinafter referred to as Tr.—pp. 274-275] and of a decision of the Tax Court determining

against petitioner Gertrude H. Gaylord (hereinafter called Mrs. Gaylord) certain deficiencies in her income taxes for the taxable years 1936, 1937 and 1939. [Tr. pp. 273-274.] Petitioners are individuals who at all times since prior to the year 1936 have been residents of Pasadena in Los Angeles County, California. The respondent (hereinafter called Commissioner) is the duly appointed, qualified and acting Commissioner of Internal Revenue. Petitioners filed with the Collector of Internal Revenue for the Sixth District of California, at Los Angeles, California, their respective individual returns of the income taxes with respect to which such deficiencies were so determined. Said district and the office of said Collector are located within the jurisdiction of the United States Circuit Court of Appeals for the Ninth Circuit. Jurisdiction of said Court to review said decisions is provided for in *Sections 1100, 1141, and 1142 of the United States Internal Revenue Code.*

Statement of the Case

On September 17, 1941, Commissioner mailed to petitioner Mr. Gaylord a notice of deficiency in which Commissioner advised Mr. Gaylord that the determination of his income liability for the taxable years 1936 through 1939 disclosed a deficiency of $49,518.76, or $17,835.82 for 1936, $12,033.50 for 1937, $10,442.62 for 1938 and $9,-206.82 for 1939. [Tr. pp. 44-61.] On November 10, 1941, Mr. Gaylord filed with the United States Board of Tax Appeals (now the Tax Court) his verified petition for redetermination of such deficiency [Tr. pp. 6-96]; to which petition Commissioner filed his answer December 9, 1941. [Tr. pp. 97-101.]

On September 17, 1941, Commissioner also mailed to petitioner Mrs. Gaylord, petitioner George S. Gaylord's

wife, a notice of deficiency in which Commissioner advised her that the determination of her income tax liability for the taxable years 1936 through 1939 disclosed a deficiency of $8,043.63, or $1,087.40 for 1936, $4,925.01 for 1937, $32.51 for 1938 and $1,998.71 for 1939. [Tr. pp. 134-151.] On November 26, 1941, she filed with said Board her verified petition for a redetermination of such deficiency [Tr. pp. 101-187]; to which petition Commissioner filed his answer January 2, 1942. [Tr. pp. 187-191.]

As issues of fact and law involved in the cases made these petitions and answers were the same, except for differences in total amounts of money or value concerned, the Tax Court consolidated the two cases for hearing and they were heard together by that Court, the Honorable Bolon B. Turner, a Judge thereof, presiding, on April 2 and 3, 1943, at Los Angeles, California. [Tr. pp. 337 to 568.] On February 18, 1944, the Tax Court, by Judge Turner, promulgated its findings of fact and opinions deciding against Mr. and Mrs. Gaylord the issues of fact and law now brought up in their petitions for review. [Tr. pp. 192-216.] Though they moved March 17, 1944 for reconsideration by said Court of its determination, so announced, that (1) the income for the years 1936 through 1939 of the hereinafter referred to trust was taxable to Mr. and Mrs. Gaylord, and (2) the basis for computing gain on certain stock sales by them and said trust during said years was less than the value claimed by them, said Court denied such motion March 18, 1944. [Tr. pp. 223-249.] There followed the decisions, of which review is now sought, in which said Court determined against Mr. Gaylord a deficiency in his income tax of $17,826.37 for 1936, $12,029.07 for 1937, $8,211.85 for 1938 and $9,-

206.82 for 1939, and against Mrs. Gaylord a deficiency in her income tax of $1,087.10 for 1936, $4,922.60 for 1937, and $1,998.19 for 1939. However, as Mr. Gaylord, after the Tax Court's decision and before filing his petition for review thereof, paid certain sums on deficiencies so found against him for 1937, 1938 and 1939, the present review proceedings concern as to him for those three years $11,965.36 for 1937, $8,074.13 for 1938 and $7,-925.35 for 1939. [Tr. pp. 276-277.] Issues as to deductions for losses sustained by petitioners on demolition of a building and loss to Mr. Gaylord from destruction of a pear orchard, which were before the Tax Court and are discussed in its findings of fact and opinions, are not involved in these present proceedings for review.

There are two principal questions now presented for review:

(A) Was said trust at any time during the years 1936 through 1939 irrevocable by the trustors thereof, Mr. and Mrs. Gaylord, or either of them and consequently the trust income for those years taxable to them?

(B) What was the basis for computing gain on certain stock sales made by Mr. and Mrs. Gaylord and said trust during those years?

(A) Question of Revocability of the Trust.

As to this question the facts are undisputed and no evidence to the contrary was presented or offered by the Commissioner.

Mr. and Mrs. Gaylord were husband and wife at all times herein mentioned. [Tr. pp. 339, 542.] As issue of their marriage they have two daughters, Margaret Gaylord Ruppel (hereinafter called Mrs. Ruppel) and Gert-

rude Gaylord Bruce (hereinafter called Mrs. Bruce) both of whom are living. Margaret was born November 10, 1904, and married Albert Brunker in 1923. Two children, both now living, were born of this marriage, Barbara Brunker October 14, 1925, and Robert Henry Brunker June 3, 1928. Subsequently Margaret divorced Brunker and in 1931 married Frederick Ruppel. The other daughter, Gertrude, was born May 31, 1916, and on May 29, 1937, married Eugene L. Bruce. They have one child, Ann Bruce, who was born in April, 1938, and is living. [Mr. Gaylord's testimony, Tr. p. 353; Tax Court's Findings of Fact—hereinafter referred to as Findings—Tr. p. 195.]

Sometime prior to their executing the declaration of trust dated November 7, 1935, hereinafter referred to, it was mutually agreed between Mr. and Mrs. Gaylord that they would form an irrevocable trust for the uses and purposes and upon the terms and conditions set forth in such declaration and that Mr. Gaylord would contribute to the trust estate to be provided for in such declaration 5000 shares of Marathon Paper Mills Company common stock owned by him as his separate property and that Mrs. Gaylord would give to such trust estate 2000 shares of such stock owned by her as her separate property, each of such contributions being conditioned upon the other being so made to such trust. Accordingly, they told their attorney that they wanted to form such an irrevocable trust and instructed him to prepare therefor a declaration of trust. He thereupon prepared a declaration of trust dated November 7, 1935, which Mr. and Mrs. Gaylord signed about December 11, 1935, on which day they acknowledged before a notary in Los Angeles County, California, its execution. In connection with Mr. and Mrs. Gaylord's so signing and acknowledg-

ing such declaration of trust and at that time they were advised by their counsel that the trust was irrevocable. After being signed the instrument was left in their counsel's custody. Pursuant to their precedent agreement, Mr. Gaylord contributed his 5000 shares and Mrs. Gaylord her 2000 shares of Marathon Paper Mills common stock in the year 1935. Both of them in creating said trust (hereinafter referred to as the trust) proposed, intended and understood that they were forming an irrevocable trust of that stock and its proceeds for the uses and purposes and upon the terms and conditions set forth in such declaration and that neither they nor either of them had any power to revoke such trust or modify or change it in any manner. [Mr. Gaylord's testimony, Tr. pp. 339-340, 351, 353-354, 381, 541-542; Mrs. Gaylord's testimony, Tr. pp. 542-544; Findings Tr. pp. 195-196, 202.]

Upon acquisition for the trust by its trustees, with proceeds of sale of certain of the stock thus contributed, of real property in the jurisdictions hereinafter mentioned, the trustees of said trust had said declaration recorded September 23, 1937, in Los Angeles County, California, and in 1938 in Cameron, Hidalgo, Potter and Jim Wells Counties, Texas. [Mr. Gaylord's testimony, Tr. pp. 351-352; Findings, Tr. 197.] For such Texas recordings there was additional acknowledgment of execution of said declaration by Mr. and Mrs. Gaylord and certification thereon of such acknowledgment in Texas form on January 6, 1938, before the same notary who took their original acknowledgments. [Mr. Gaylord's testimony, Tr. p. 354.]

By stipulation of counsel and order of the Tax Court made at the hearing before it, the original of said declaration of trust dated November 7, 1935, which was received

in evidence [Mr. Gaylord's testimony, Tr. pp. 339-340, 359] was withdrawn, and the copy thereof set forth as Exhibit B in Mr. and Mrs. Gaylord's respective petitions then before that Court was substituted therefor with two minor corrections. [Tr. pp. 359-360; Stipulation, Tr. pp. 569-570.] Said declaration is set forth in full on pages 61 to 76, and again on pages 151 to 166, of the Transcript of the Record herein and is summarized in the present petitions for review. [Mr. Gaylord's Petition, Tr. pp. 282-285; Mrs. Gaylord's Petition, Tr. pp. 312 to 315.] According to its terms, the trust is to last as long as either Mrs. Ruppel or Mrs. Bruce is living and under thirty years old, and during its existence all of the trust's net income is to be distributed, in any event annually, to them, or, in case of the death of either of them leaving lawful issue, the latter. Upon termination of the trust its estate vests in Mrs. Ruppel and Mrs. Bruce or, if either of them fail to survive such termination, her lawful issue who may then be living. Though said declaration contained no statement that it was irrevocable, no right to change or revoke the trust was reserved.

In connection with the trust's creation and as part of the same transaction, Mr. and Mrs. Gaylord each personally signed and under date of February 3, 1936, executed a gift tax return for the calendar year 1935, which was filed in the office of the Collector of Internal Revenue at Los Angeles, California, March 10, 1936. Mr. Gaylord's said return included his contribution to the trust of his 5000 shares of Marathon Paper Mills stock mentioned in said declaration of trust, and Mrs. Gaylord's said return covered her 2000 shares of such stock appearing in said declaration of trust. In each such return specific reference was made to the trust and it was expressly declared that the "gift" represented by the aforementioned contribution

to the trust was made "By the creation of an irrevocable trust for the benefit of another." All entries in said returns are in Mr. Gaylord's own handwriting. [Mr. Gaylord's testimony, Tr. pp. 356-358, 360-363; Mrs. Gaylord's testimony, Tr. pp. 543-544; Mr. Gaylord's said Gift Tax Return, Petitioners' Exhibit 2, Tr. pp. 360A-360D; Mrs. Gaylord's Gift Tax Return, Petitioners' Exhibit 3, Tr. pp. 362A-362C; Findings, Tr. pp. 196-197.] With said returns there was filed with said Collector a copy of said declaration of trust. [See Respondent's Exhibit I, Fiduciary Return of Income of Mr. and Mrs. Gaylord, trustees, for calendar year 1936, Tr. p. 461; Mr. Gaylord's testimony, Tr. p. 381; Findings, Tr. p. 205.] The only trust to which reference was made in said returns was the trust provided for in said declaration of trust dated November 7, 1935. There was no other trust then in existence. [Mr. Gaylord's testimony, Tr. pp. 358, 360; Mrs. Gaylord's testimony, Tr. p. 544.] Mr. Gaylord, upon so filing his said return, paid $2531.27 gift tax shown thereon and later, under date of December 28, 1936, paid an additional $90.05 assessed on said return. No part of any tax so paid was ever refunded to Mr. Gaylord. [Mr. Gaylord's testimony, Tr. pp. 357-358, 381; Findings, Tr. p. 197.] Because of exemptions and exclusions no gift tax was payable by Mrs. Gaylord on her return. [Petitioners' Exhibit 3, Tr. pp. 362B-362C.]

In the beginning of the year 1940, long before any question was raised as to revocability or irrevocability of the trust, Mr. and Mrs. Gaylord, upon advice of counsel and out of abundance of caution, executed a *Declaration being a part of a certain declaration of trust dated November 7, 1935*, which was dated November 7, 1935, and acknowledged and sworn to by them under date of March 27, 1940, before a notary public in Los Angeles

County and recorded in that county March 28, 1940. In this instrument, after referring to the hereinbefore mentioned declaration of trust, dated November 7, 1935, Mr. and Mrs. Gaylord declared that the trust provided for in said declaration was always intended and is intended by them to be and is and shall always be absolutely irrevocable and that such further declaration is and is intended to be and shall always be a part of and taken with and construed as a part of said declaration of trust the same as though it had been physically incorporated in said declaration of trust. [Mr. Gaylord's testimony, Tr. pp. 363-365, 381.] This supplemental declaration, so acknowledged and sworn to in March, 1940, was received in evidence as Petitioners' Exhibit 4, but by stipulation of counsel and leave of Court Exhibit C of the petitioners' respective petitions to the United States Board of Tax Appeals was substituted for the original of said instrument and the latter was permitted to be withdrawn. Said Exhibit C is set forth on pages 76 to 80 and repeated on pages 166 to 170 of the Transcript of the Record.

The above mentioned 7000 shares of Marathon Paper Mills common stock referred to in said declaration of trust dated November 7, 1935, were subsequently sold by Mr. and Mrs. Gaylord as trustees of the trust as follows: 4000 in 1936, 1600 in 1937, 1000 in 1938 and the remaining 400 in 1939. Such sales are shown in the fiduciary returns of the trust income for these years by Mr. and Mrs. Gaylord as such trustees. [Mr. Gaylord's testimony, pp. 354-355, 381; Respondents' Exhibit I, Fiduciary Return of Income of Mr. and Mrs. Gaylord for calendar year of 1936, Tr. pp. 460-465; Respondent's Exhibit J, said trustees' Fiduciary Income Tax return for calendar year 1937, Tr. pp. 465-471; Respondent's Exhibit

K, said trustees' Fiduciary Income Tax return for calendar year 1938, Tr. pp. 471-480; Respondent's Exhibit L, said trustees' Fiduciary Income Tax returns for calendar year 1939, Tr. pp. 480-489; Findings, Tr. pp. 197-198.]

The certificates for such shares were kept in a California safe deposit box in the name of the trustees of the trust until they commenced to sell such shares, when, from time to time, they sent certificates therefor to the Harris Trust & Savings Bank, at Chicago, Illinois, for convenience of delivery upon sale. All said 7000 shares were sold and delivered upon sale either in Chicago, Illinois, or the City of New York, New York. It was only in those two places that sales of such shares were made by the trustees. All such sales were for cash, all of which was deposited by the trustees in the Harris Trust & Savings Bank, Chicago, Illinois. [Mr. Gaylord's testimony, Tr. p. 355; Findings, Tr. p. 197.]

The funds of the trust in the years 1936, 1937 and 1938 were kept on deposit in the names of the trustees as such trustees with said Harris Trust & Savings Bank in Chicago, Illinois. In the years 1939, 1940 and 1941 all of the trust's bank accounts were kept with that bank and with Bankers Trust Company in New York. [Mr. Gaylord's testimony, Tr. pp. 355, 381; Findings, p. 197.]

During 1938, $94,000 of the proceeds of sales theretofore made of Marathon Paper Mills stock of the trust was invested by its trustees in and by way of purchase for the trust, of improved income producing real properties in Texas, located in the cities of Amarillo, Alice, McAllen and Harlingen. Title to such property so purchased was taken in the names of Mr. and Mrs. Gaylord as such trustees. This property has ever since been owned and held by such trustees for the benefit of the trust and

its beneficiaries. Mr. Gaylord's testimony, Tr. pp. 352-353, 363, 381; Findings, Tr. p. 197.]

All rents belonging to the trust received by its trustees from such Texas real property in 1938 and 1939 were included in the fiduciary returns by said trustees of the trust's income for those years. The net rents from said real property so included amounted to $3859.00 for 1938 and $6370.67 for 1939. [Mr. Gaylord's testimony, p. 353; Respondent's Exhibit K, Tr. pp. 472, 477; Respondent's Exhibit L, Tr. pp. 481, 486; Findings, Tr. pp. 197-198.]

Each of the two beneficiaries of the trust, Mrs. Ruppel and Mrs. Bruce, who were then entitled to all the net income thereof in equal shares, included in her individual income tax return for each of the years 1936, 1937, 1938 and 1939, her one-half share of the trust's net income for that year shown in the fiduciary return of the trustees of the trust for that year, including her share of the trust's net income from the Texas real property rents, and paid to the Collector of Internal Revenue at Los Angeles, California, with whom said individual and fiduciary returns were filed, income tax on her one-half of the net income of the trust. Such income included her share of taxable capital gain, as shown by said fiduciary returns, on the above mentioned sales in 1936 through 1939 of the 700 shares of trust's Marathon Paper Mills stock. [Mr. Gaylord's testimony, Tr. p. 353; Respondent's Exhibit I, Fiduciary Return of Income of said trust for 1936, Tr. pp. 461-465; Respondent's Exhibit J, Fiduciary Return of Income of said trust for 1937, Tr. pp. 465-471; Respondent's Exhibit K, Fiduciary Return of Income of said trust for year 1938, Tr. pp. 471-480; Respondent's Exhibit L, Fiduciary Return of Income of said trust for

year 1939, Tr. pp. 481-487; Respondent's Exhibit M, Mrs. Ruppel's Individual Income Tax Return for 1936, Tr. p. 508; Respondent's Exhibit N, Mrs. Ruppel's individual Income Tax Return for 1937, Tr. pp. 509-512; Respondent's Exhibit O, Mrs. Ruppel's Individual Income Tax Return for year 1938, Tr. pp. 513-517; Respondent's Exhibit P, Mrs. Ruppel's Individual Income Tax Return for year 1939, Tr. pp. 519-522; Respondent's Exhibit Q, Mrs. Bruce's Individual Income Tax Return for the year 1936, Tr. pp. 523-525; Respondent's Exhibit R, Mrs. Bruce's Individual Income Tax Return for the year 1937, Tr. pp. 527-531; Respondent's Exhibit S, Mrs. Bruce's Individual Income Tax Return for the year 1938, Tr. pp. 531-536; Respondent's Exhibit T, Mrs. Bruce's Individual Income Tax Return for the year 1939, Tr. pp. 537-540.]

On the foregoing facts respondent Commissioner determined and contended before the Tax Court that the trust was revocable by Mr. and Mrs. Gaylord, or either of them, at all times during the years 1936 through 1939 and, consequently, under the provisions of *Section 22 (a)* or *Section 166 of the Revenue Acts of 1936 and 1938* and/or the same sections of Internal Revenue Code, and that all income of the trust for those years, which in those years had been distributed by the trustees to the beneficiaries Mrs. Ruppel and Mrs. Bruce constituted income of Mr. and Mrs. Gaylord in the relative proportions of their respective contributions to the trust, that is, 2/7ths to Mrs. Gaylord, because she had contributed 2000 of the 7000 shares of Marathon Paper Mills Company stock to the trust, and 5/7ths to Mr. Gaylord, because he had contributed the other 5000 shares of such 7000 shares forming the original corpus of the trust, and, accordingly,

that Mr. Gaylord was chargeable with the following amounts of the trust's net income: For 1936, $31,284.44; for 1937, $23,620.76; for 1938, $14,446.25; and for 1939, $18,001.89 [Notice of Deficiency dated Sep. 17, 1941, Tr. pp. 46-54, 57-58; Findings, p. 194] and Mrs. Gaylord with these amounts of the trust's net income: For 1936, $12,516.36, for 1937, $9,449.31; and for 1939, $7,201.17 [Notice of Deficiency dated Sep. 17, 1941, Tr. pp. 136-144 148-149; Findings, p. 194.] On the contrary, petitioners contended to the Commissioner and before the Tax Court, and still maintain, that the trust is and has always been irrevocable and that none of its income was ever taxable to either Mr. or Mrs. Gaylord.

(B) Question as to Computing Gain on Stock Sales.

In addition to the sales made by the trust in the years 1936 through 1939 of Marathon Paper Mills stock belonging to it, Mr. Gaylord sold shares of such stock then owned by him as his separate property as follows: In 1936, 4950; in 1937, 2800; in 1938, 3300; and in 1939, 2362 [Mr. Gaylord's testimony, pp. 366, 381; Respondent's Exhibit A, Mr. Gaylord's Individual Income Tax Return for 1936, Tr. pp. 383-384, 387-388; Respondent's Exhibit B, Mr. Gaylord's Individual Income Tax Return for 1937, Tr. pp. 392, 399; Respondent's Exhibit C, Mr. Gaylord's Individual Income Tax Return for 1938, Tr. pp. 405, 408, 415-417; Respondent's Exhibit D, Mr. Gaylord's Individual Income Tax Return for 1939, Tr. pp. 422, 424, 430, 431] and Mrs. Gaylord also sold the following shares of such stock then owned by her as her separate property as follows: In 1937, 2100; and in 1939, 500 [Tr., Mr. Gaylord's testimony, pp. 366, 381; Respondent's Exhibit F, Mrs. Gaylord's Individual Income Tax Return for 1937, Tr. pp. 441-446]; Respondent's Exhibit H,

Mrs. Gaylord's Individual Income Tax Return for 1939, Tr. pp. 455-456, 458-459.] The 2000 shares contributed by Mrs. Gaylord to the trust in 1935 had been received by her as a gift from Mr. Gaylord in 1930 [Mr. Gaylord's testimony, Tr. pp. 373-374] and the 2600 shares of such stock sold by her as her separate property in 1937 and 1939 had been given to her by Mr. Gaylord in February, 1932 [Findings, Tr. p. 211.]

It is conceded that all 7000 shares belonging to the trust and constituting the original corpus thereof and said additional 2600 shares belonging to Mrs. Gaylord have the same basis for computing gain on sale thereof which they had when they belonged to Mr. Gaylord before he gave to Mrs. Gaylord or contributed to the trust any of such shares. All of the Marathon Paper Mills Company stock sold by the trustees or Mr. or Mrs. Gaylord in the period 1936 to 1939 has the following history:

On July 1, 1917, Mr. Gaylord owned 337 shares (which, purchased at various times from previous to March 1, 1913, to July 1, 1917, cost him $34,436.50) and his partner, H. S. Clinedinst (hereinafter called Clinedinst) owned 337 shares of a total 726 shares of common stock of Menasha Carton Company, the remaining 52 shares belonging to other individuals. Clinedinst also owned all of the stock of Menasha Printing Company. These two businesses were across the street from each other in Menasha, Wisconsin. Clinedinst desired to consolidate or merge the assets and businesses conducted by these two corporations into a new corporation with Mr. Gaylord as its manager. For that purpose an agreement was entered into between Clinedinst and Mr. Gaylord for such consolidation or merger (hereinafter referred to as "consolidation") of the two companies, which resulted in the

Menasha Printing and Carton Company. The agreement provided, among other things, that Mr. Gaylord should acquire sufficient stock of the new corporation to bring his holdings therein up to 40% of its outstanding stock. [Mr. Gaylord's testimony, Tr. pp. 366-367, 369, 381; Findings, Tr. pp. 206-207.]

For convenience in determining the respective proportion of interest in the new Menasha Printing and Carton Company to be received by each of the stockholders of Menasha Carton Company and Menasha Printing Company (but not the real values involved going into and resulting from such consolidation) an appraisal was made at the time, by competent appraisal company, of the tangible assets of the Menasha Carton Company and the Menasha Printing Company, and the values shown by such appraisal plus the "quick assets" of the combining companies was the gauge used for determining as between each of the stockholders of these two companies his proportion of interest in the new company. [Mr. Gaylord's testimony, Tr. pp. 367-370, 566; Findings, p. 207.]

The consolidation was effected in August, 1917, as of July 1, 1917. In it Mr. Gaylord received for his 337 shares of Menasha Carton Company stock and his promissory note for $152,161.11 dated August 30, 1917, payable to Clinedinst's order 3 years after date with interest at 6% per annum (which note was paid in full in 1924) 1975 shares of the common and 410 shares of the preferred stock of the new company, Menasha Printing and Carton Company. The par value of said 1975 shares of common and 410 shares of preferred stock was equal (approximately) in amount to the principal sum of said promissory note plus the value of the proportionate part of the tangible assets of the two combined companies as

so appraised and their "quick assets" to which Mr. Gaylord's interest in the Menasha Carton Company entitled him. His 337 shares of that company then had a real and actual value far in excess of that determined by such appraisal of tangible assets plus such "quick assets," which determination was resorted to only for the purpose of fixing the *proportion* and not the full or true value of the respective participation in the new Menasha Printing and Carton Company of the several owners of the two companies which were being consolidated into it. For such purpose only no account was taken of goodwill, earning capacity or value as a profitable going concern of either of the companies. The profits of the Menasha Carton Company for the first seven months of 1917 were $56,000, and of the Menasha Printing Company for the first six months of 1917, $187,000 in round figures. Combined profits at the end of 1917 for these two concerns operated separately for the first six months of that year and for the new company for the last six months of 1917 were $315,000 in round figures. Determination of value of the stock of the Menasha Carton Company and the Menasha Printing Company from capitalization of such current earnings at ten times the amount thereof, a conservative rate, and taking into consideration all pertinent factors or elements such as good will, earning capacity and worth of the businesses as profitable, going concerns, results in a substantially higher value for such stock than that indicated by value of tangible assets plus "quick assets" only. Such determination demonstrates a fair market value of at least $350,000 for Mr. Gaylord's said 337 shares of Menasha Carton Company at the time of such consolidation. [Mr. Gaylord's testimony, Tr. pp. 367-368, 369-372, 373, 374-375, 381, 562, 563-564, 566; Findings, 207-208.]

In making the consolidation the appraised value of the physicial assets plus book value of the "quick assets" of the Menasha Carton Company was determined to be $186,000, and of the Menasha Printing Company, $774,000, a total of $960,000. [Gaylord's testimony, Tr. pp. 370-373, 566; Findings, Tr. p. 207.] For all assets of these two corporations, including good will, earning capacity and value as going concerns, the new corporation, Menasha Printing & Carton Company, issued 5000 shares common and 4600 shares preferred stock, all of the par value of $100 per share. [Findings, pp. 207-208.] Of the $186,000 value of tangible and "quick assets" of the Menasha Printing Company $86,338.89 was allocated to Mr. Gaylord's 337 shares of stock of that company. [Mr. Gaylord's testimony, Tr. pp. 367, 370-372; Petitioners' Exhibit 5, Tr. p. 372A; Findings, Tr. p. 208.]

Though the exchange of his 337 shares of Menasha Carton Company for stock in the new corporation resulted in taxable gain to him, Mr. Gaylord, through inadvertence and mistake, did not report in his income tax return for 1917 any income on such exchange. [Tr. pp. 377-378; Findings, Tr. p. 209.]

In 1922 or 1923 Mr. Gaylord purchased the remaining interest of Clinedinst in the Menasha Printing and Carton Company. In the meantime all preferred stock issued in the 1917 consolidation had been retired. During the interval between such consolidation and October 31, 1927, Mr. Gaylord sold to employees some small lots of his common stock of Menasha Printing and Carton Company. In 1925 he received a 100% stock dividend on the stock of that company then held by him. As of date October 31, 1927, he owned 3357 shares of said stock. [Mr. Gaylord's Testimony, pp. 374-375; Exhibits F, G and H

to petitioners' respective petitions to United States Board of Tax Appeals, Tr. pp. 92-96, 182-187; Findings, p. 209.]

Of the stock so held 350 shares had been transferred by Mr. Gaylord in 1925 to his brother C. W. Gaylord for 432 shares Robert Gaylord, Inc. stock. Thereafter C. W. Gaylord, wanting to reacquire the latter for use in connection with reorganization of Robert Gaylord, Inc., Mr. Gaylord proposed to sell such shares to C. W. Gaylord for $300,000 but the offer was not accepted and thereafter C. W. Gaylord suggested that the previous exchange of 350 shares of Menasha Printing and Carton Company for 432 shares of Robert Gaylord, Inc. stock be cancelled and the parties restored to the position they would have been in if the exchange had never been made. This was done and Mr. Gaylord returned to C. W. Gaylord the 432 shares of Robert Gaylord, Inc. stock and received back 352 shares of Menasha Printing and Carton Company stock, each of the parties paying over to the other all dividends received by him on the stock involved in the exchange standing in his name during the interval. These exchanges between Mr. Gaylord and C. W. Gaylord were taxable, although, through inadvertence and mistake, not considered so by Mr. Gaylord at the time. [Mr. Gaylord's Testimony, Tr. pp. 379-381; Exhibit H to petitioners' respective petitions to Board of Tax Appeals, pp. 95-96, 186; Findings, pp. 209-210.]

On October 31, 1927, Menasha Products Company (such then being the name of Menasha Printing and Carton Company) was merged with Marathon Paper Mills Company. In this tax-free reorganization Mr. Gaylord received 6728 shares of the Marathon Paper Mills Company stock, and $1,038,000 in face value of Marathon

Paper Mills Company 5% bonds in exchange for his 3,357 shares of common stock of Menasha Products Company. In 1929 the last mentioned shares were split 4 for 1. [Mr. Gaylord's Testimony, pp. 374-375, 379; Exhibit H to petitioners' respective petitions to Board of Tax Appeals, pp. 95-96, 185-186; Findings, p. 210.]

The fair market value of Mr. Gaylord's stock in the Menasha Carton Company which he contributed to the reorganization of the Menasha Carton Company and the Menasha Printing Company into the Menasha Printing and Carton Company made as of July 1, 1917, was on that date at least $350,000.00. [Gaylord's Testimony, pp. 363-364, 366, 367-370.] Said Exhibit G to said petitions. [Gaylord's Testimony, Tr. pp. 95, 185-186; Findings, p. 210.]

As a result of the foregoing history of the Marathon Paper Mills Company stock sold by the trust and Mr. Gaylord through 1936 to 1939 and Mrs. Gaylord in 1936, 1937 and 1939, they computed gain thereon on a basis of $8.21 per share and income tax was paid accordingly by Mr. and Mrs. Gaylord and the beneficiary daughters of said trust. (See fiduciary returns of income of the trust for the years 1936 to 1939, and income tax returns of Mr. Gaylord individually for the years 1936 to 1939, of Mrs. Gaylord for the years 1936, 1937 and 1939 and of Mrs. Ruppel and Mrs. Bruce individually for the years 1936 to 1939 in Transcript of the Record hereinbefore cited.)

But respondent Commissioner determined and contended before the Tax Court [Notice of Deficiency dated Sep. 17, 1941, Exhibit A to Mr. Gaylord's petition to Board of Tax Appeals, Tr. pp. 47-51, 52-53, 54, 56-59; Notice of Deficiency dated Sept. 17, 1941, Exhibit A to Mrs.

Gaylord's petition to said Board [Tr. pp. 137-141, 144, 148-149] that for the purpose of computing capital gains realized through the years 1936 to 1939 by the trust and by Mr. Gaylord and by Mrs. Gaylord in the years 1936, 1937 and 1939, from the sales of its, his and her respective shares of Marathon Paper Mills Company common stock, the statutory basis for computing gain on each such sale was $2.83542 per share, and, consequently, as to such sales, there were the following gains realized:

On sale in 1936 by the trust of 4000 shares, $21,498.32, of which 30%, or $6,449.50, is to be taken into account under *Section 117(a) of the Revenue Act of 1936;*

On sale in 1936 by Mr. Gaylord of 4950 shares, $26,604.17, of which 30%, or $7,981.25, is so to be taken into account;

On sale in 1937 by the trust of 1600 shares, $8,599.33, of which 30% or $2,579.80, is so to be taken into account;

On sale in 1937 by Mr. Gaylord of 2800 shares, $15,048.82, of which 30%, or $4,514.65, is so to be taken into account;

On sale in 1937 by Mrs. Gaylord of 2100 shares, $11,286.62, of which 30%, or $3,385.99, is so to be taken into account;

On sale in 1938 by the trust of 1000 shares, $5,-374.58, of which 50%, or $2,687.29, is to be taken into account under *Section 117(b) of the Revenue Act of 1938;*

On sale in 1938 by Mr. Gaylord of 3300 shares, $17,736.11, of which 50%, or $8,868.06, is so to be taken into account;

On sale in 1939 by the trust of 400 shares, $2,149.83, of which 50%, or $1,074.92, is to be taken into account under *Section 117(b) of the Internal Revenue Code;*

On sale in 1939 by Mr. Gaylord of 2362 shares, $12,694.77, of which 50%, or $6,347.38, is so to be taken into account; and

On sale in 1939 by Mrs. Gaylord of 500 shares, $2,687.29, of which 50%, or $1,343.64, is so to be taken into account.

To the contrary, petitioners contend to the Commissioner, and before said Court, and still maintain, that the statutory basis for computing gain on each such sale was a minimum of $8.21 per share as claimed on their individual income tax returns and the fiduciary returns for the trust filed for the years above mentioned.

Respondent Commissioner offered no evidence to controvert the petitioners' evidence that Mr. Gaylord's 337 shares of Menasha Carton Company had at the time of its merger with the Menasha Printing Company a fair market value of at least $350,000.

On their petitions for redetermination of the hereinbefore referred to deficiencies, The Tax Court held with respect to the subjects and issues involved in these present proceedings for review by the Circuit Court of Appeals for the Ninth Circuit,

(1) that the trust was revocable during the taxable years 1936 through 1939 and that of the trust income for those years 5/7ths was taxable to Mr. Gaylord and 2/7ths to Mrs. Gaylord [Findings, pp. 205-206]; and

(2) that the basis for computing gain on the sales by the petitioners individually and by the trustees of the

trust of Marathon Paper Mills Company common stock was (except as to 100 shares purchased by Mr. Gaylord in 1933 for $1,700, as to which there is no dispute) $2.84276 per share instead of $8.21 per share as claimed by them. [Tax Court's Decisions, Tr. pp. 273-275.] Accordingly, the Tax Court determined the deficiencies hereinbefore stated of which petitioners complain.

Specifications of Error.

Mr. Gaylord in his petition for review of the decision of the Tax Court against him and Mrs. Gaylord in her petition for review of the decision of that court against her set forth certain assignments of error [Mr. Gaylord's said petition, Tr. pp. 299-302; Mrs. Gaylord's said petition, Tr. pp. 329-332] which have been adopted as their points of appeal [Adoption of Assignments of Error, Tr. pp. 578-579.] As already indicated, such assignments of error and points on appeal present only two principal questions for review:

(A) Whether the trust hereinbefore referred to was revocable, and

(B) What was the correct basis for computing gain on the sales of the Marathon Paper Mills Company common stock. Consequently the Specifications of Error may be succinctly stated as follows:

I.

The Tax Court erred in determining that the trust was revocable during the years 1936 through 1939 and in failing to find and decide as a matter of fact and of law that the trust was at all times from its inception in 1935 an irrevocable trust.

II.

The Tax Court erred in concluding that estoppel is not an issue in this case and in deciding that respondent

Commissioner is not estopped to claim that the trust was revocable.

III.

The Tax Court erred in determining that all of the income of the trust which was distributed by the trustees to and received by the beneficiaries of the trust in the years 1936 through 1939 was income of Mr. and Mrs. Gaylord and not of such beneficiaries.

IV.

The Tax Court erred in deciding, contrary to law and fact, that the $3,859.95 rent for the year 1938 and the $6,370.67 rent for the year 1939 of the Texas real property belonging to the trust was income of a revocable trust and hence income of Mr. and Mrs. Gaylord and not of the beneficiaries of the trust.

V.

The Tax Court erred in deciding, contrary to law and to fact, that the basis for computing gain on the above referred to sales of Marathon Paper Mills Company common stock (with exception of 100 shares) was $2.84276 per share instead of a minimum of $8.21 per share as claimed by petitioners.

VI.

The Tax Court erred in failing to find and decide that under Section 202(a) of the 1926 Revenue Act the cost to Mr. Gaylord of the 352 shares of Menasha Printing and Carton Company stock which he received from his brother C. W. Gaylord in 1927 in exchange for 432 shares of Robert Gaylord, Inc. was the fair market value of such shares of Menasha Printing and Carton Company in August, 1927.

The foregoing will now be considered in order.

I.

The Tax Court Erred in Determining That the Trust Was Revocable During the Years 1936 Through 1939 and in Failing to Find and Decide as a Matter of Fact and of Law That Said Trust Was at All Times From Its Inception in 1935 an Irrevocable Trust.

Were it not for the 1931 amendment to *Section 2280 of the California Civil Code* any contention that the trust provided for in the declaration of trust dated November 7, 1935, was revocable would be utterly lacking any plausible support in law. It is only because of that amendment that specious color is lent to respondent's position and the Tax Court's holding that the trust is irrevocable. But *Section 2280 of the California Civil Code,* as amended in 1931, is inapplicable to the trust herein involved because

(a) the trust is not a "voluntary trust" within the meaning or purpose of *Section 2280* as so amended;

(b) the original and unchanged understanding, purpose, intent and belief of the parties thereto that the trust was always to be irrevocable had the effect of supplying any scrivener's omission to include in the original declaration of trust dated November 7, 1935, express words of irrevocability and therefore such declaration of trust must be deemed in any case, as of the time such trust became effective, corrected in such respect and read as though it did contain an expression of irrevocability;

(c) in any case sufficient and effective expression or declaration that the trust is irrevocable is found in each of the gift tax returns signed and made under oath by each of the trustors to the Collector of Internal Revenue in 1936 shortly following

upon and in connection with the trustors' making of such declaration of trust and in which gift tax returns the trust was referred to and a copy of the declaration of trust filed therewith as a part thereof;

(d) the execution by the trustors, signed and acknowledged and made under oath by each of them, of the DECLARATION BEING A PART OF A CERTAIN DECLARATION OF TRUST DATED NOVEMBER 7, 1935, which is dated that date but was not recorded until March, 1940, wherein they certify and declare that the trust provided for in said declaration of trust was always intended and is intended by the trustors and trustees therein to be and is and shall always be absolutely irrevocable, which statement was so made under oath by the trustors and trustees, Mr. and Mrs. Gaylord, long before any issue or controversy was intimated, suggested or raised by any tax authority based upon the claim that the trust was irrevocable and was so made out of abundance of caution promptly upon omission in said declaration dated November 7, 1935, of an expression of irrevocability being called to Mr. and Mrs. Gaylord's attention, is again a sufficient and effective expression or declaration relating back for all purposes to the very inception of the trust, that the trust always was and is irrevocable;

(e) said declaration of trust shows on its face that it was intended to be operative under the laws of jurisdictions other than California, and under the law of every jurisdiction in the United States outside of California the trust set forth in said declaration in the form there stated would, without more,

at the time said declaration was executed, be irrevocable;

(f) many of the operations and transactions of the trustees of the trust since its inception have been outside of California and in jurisdictions where the trust has always been absolutely irrevocable; and

(g) under the laws of California the trust of the stock referred to in said declaration of trust dated November 7, 1935, formed by Mr. and Mrs. Gaylord for the benefit of their daughters and their living issue has at all times since its inception in 1935 been valid in any case as an oral irrevocable trust of personal property which needed no writing, and the proceeds of the stock constituting the corpus of such trust, no matter how subsequently invested or in what form transmuted, always remain subject to such oral irrevocable trust.

These several points above mentioned under the first specification of error will now be considered:

(a) *The Trust Is Not a "Voluntary" Trust Within the Meaning or Purpose of Section 2280 as Amended in 1931.*

The trust here involved was not created by and did not result from the act or declaration of one person alone. As shown by the uncontradicted evidence and as substantially found by the Court, it was created pursuant to a mutual understanding and agreement theretofore had between Mr. Gaylord and his wife, Gertrude H. Gaylord, whereby he, in consideration of her agreement to contribute to an irrevocable trust to be created and provided

for the uses and purposes and upon the terms and conditions later expressed in the declaration of trust dated November 7, 1935, 2000 shares of Marathon Paper Mills Company common stock then separately owned by her, such shares to be part of the trust estate provided for in such trust, agreed to contribute to such trust as part of such trust estate in trust for the same uses and purposes and upon the same terms and conditions 5000 shares of said stock owned by him as his separate property, and she, on her part agreed, that in consideration of Mr. Gaylord's agreement to make such contribution of such 5000 shares, she would make such contribution of such 2000 shares. It was pursuant to such agreements that the declaration of trust was prepared for and executed by them and Mr. Gaylord contributed his 5000 shares to such trust and Mrs. Gaylord contributed her 2000 shares.

Section 2280 of the California Civil Code, as amended in 1931, reads as follows:

> "Unless expressly made revocable by the instrument creating the trust, every voluntary trust shall be revocable by the trustor by writing filed with the trustee. When a voluntary trust is revoked by the trustor, the trustee shall transfer to the trustor its full title to the trust estate. Trusts created prior to the date when this act shall become a law shall not be affected thereby."

That under the circumstances and facts in evidence herein the trust created by Mr. and Mrs. Gaylord was not a "voluntary trust" or revocable within the meaning of *Section 2280* of said Civil Code, see the case of *Touli v. Santa Cruz County Title Co.* (1937) 20 Cal. App. (2d) 395, at 497, 67 Pac. Rep. (2d) 404, at pages 405 to 406,

which, so far as known to petitioners, is the only decision of an appellate court in the State of California construing the phrase "voluntary trust" as used in *Section 2280.*

Until such 1931 amendment (an obscure bit of legislation which was not given the general publicity usually accorded to important changes in statute the law of California, even as to "voluntary trusts," with respect to revocability was the same as that of other states of the Union, that is, such trusts could not be revoked by the trustor unless by the very terms of the trust he reserved a power of revocation. In the absence of any such reserved power of revocation or modification the trust was irrevocable and could not be modified.

> *Restatement of the Law of Trusts,* as adopted and promulgated by the American Law Institute. Vol. II, Sections 330 to 332, and California Annotations to said restatements and said sections.

As is plain from its wording, said *Section 2280,* as amended, applies in any case, only to "voluntary" trusts. Though *Section 2216 of the California Civil Code,* which reads "A voluntary trust is an obligation arising out of a personal confidence reposed in, and voluntarily accepted by, one for the benefit of another." purports to define a "voluntary trust," in doing so it fails of its purpose, for it seeks to explain the word to be defined, "voluntary," by use of another form of the very same word, "voluntarily." The expression "voluntary trust" was first used in said *Section 2280* when it was redrafted by the amendment of 1931. As enacted in 1872 and as it remained until that amendment that section read:

> "A trust cannot be revoked by the trustor after its acceptance, actual or presumed, by the trustee and

beneficiaries, except by the consent of all of the beneficiaries, unless the declaration of trust reserves a power of revocation to the trustor, in which case the power must be strictly pursued."

As *Section 2216 of the California Civil Code*, above quoted, in itself throws no light on the meaning to be accorded to the word "voluntary" used in the definition there given of a "voluntary trust" the District Court of Appeals of the State of California in construing the expression "voluntary trust" appearing in said *Section 2280*, as so amended in 1931, resorted to the generally accepted meaning of the word "voluntary" as adopted in equity *jurisprudence*, that is, "without consideration; without valuable consideration; gratuitous, as a *voluntary* conveyance."

> *Black's Law Dictionary* (3d Edition, 1933) page 1823.
>
> *Bouvier's Law Dictionary* (1897).
>
> *Touli v. Santa Cruz Title Co.* (1937) 20 Cal. App. (2d) 495, 497; 67 Pac. (2d) 404, 405-406.

The court in the *Touli* case last cited, speaking of the use of the word "voluntary" in *Section 2280*, as amended, said:

> "Webster's New International Dictionary under the heading 'voluntary-law' gives this definition: 'Acting, or done, of one's own free will without valuable consideration, acting, or done, without any present legal obligation to do the thing done.' It was in the latter sense that the word 'voluntary' was used in the amended section, otherwise it would not have been coupled with the word 'revocable' without reservation." (20 Cal. App. (2d) at 497; 67 Pac. (2d) at 406.)

Hence the court there held:

> "It must follow, therefore, that when section 2280 was drafted to permit the revocation of a 'voluntary' trust, that expression *was not used in the broad sense found in section 2216, but in the restricted sense of a trust created freely and without a valuable consideration* or legal obligation." (Same page. Italics inserted.)

This decision, which is the only one found construing the phrase 'voluntary trust' appearing in *Section 2280,* is directly to the point, first, that a trust formed for a valuable consideration or created as a result of a legal obligation is not within the scope and operation of *Section 2280* and therefore such trust cannot be revoked unless expressly made revocable; *second,* that the definition of a "voluntary trust" appearing in *Section 2216 of the California Civil Code* has no bearing on the phase "voluntary trust" as used in the 1931 amendment to *Section 2280* of the same code; and *third,* that the word "voluntary" in *Section 2280* is not there used, as the Tax Court in its opinion erroneously thought [Findings, Tr. p. 201] in the sense of something done of one's own free will and as "an act of choice." Though the *Touli* case concerned a deed of trust given to secure a loan, the California court's decision that the "voluntary trust" referred to in *Section 2280* was not a "voluntary trust" as defined in *Section 2216* is not dictum but an essential part of its determination. That court, because of reliance placed by plaintiffs and respondents Touli on the amendment to *Section 2280* and the language of *Section 2216*, which gave literal support to their contention that the trust deed there involved was within the scope and meaning of *Section 2280*, was compelled to construe the ambiguities

of that amendment and ascertain just what the phrase "voluntary trust" used therein really meant; and its interpretation of the California law is obviously at variance with the views expressed by the Tax Court as to how the California statute should be construed.

In passing it may be observed that although by *Section 2217 of the California Civil Code* an involuntary trust is defined to be "one which is created by operation of law" it does not follow that all other trusts are "voluntary" in the sense in which such word is used in said *Section 2280.* As above indicated by judicial decision in California, the word "voluntary" has more than one meaning. It may refer not only to the willingness of a person to accept a trust in distinction to the imposition by law upon him unwillingly or without his consent of an involuntary trust, so-called, but as well to the characterization of a trust in equity jurisprudence where a trust willingly accepted by a trustee may or may not be a "voluntary" trust; for a trust, no matter how willingly or voluntarily accepted by the trustee, will not be considered in equity jurisprudence a voluntary trust if it is founded upon a valuable consideration. Manifestly in California law there is more than one kind of voluntary trust. In the proceedings at bar the only question as to whether or not the trust provided for in the declaration of trust dated November 7, 1935, is or is not voluntary is whether such trust is or is not voluntary within the precise meaning and scope of a particular statute. *Section 2280 of the California Civil Code.* According to the judicial interpretation and construction of that section and of the words "voluntary trust" there used, the trust now discussed, created by Mr. and Mrs. Gaylord, is not a voluntary trust because it is

grounded in a valuable consideration and on an agreement between the trustors made with such consideration.

As to all matters pertaining to this trust, it may also be observed that the principles of equity jurisprudence are those which govern; for the subject of trusts is peculiarly the province of that field of law.

Section 1605 of the California Civil Code provides that

> "Any benefit conferred, or agreed to be conferred, upon the promisor, by any other person, to which the promisor is not lawfully entitled, or any prejudice suffered, or agreed to be suffered, by such person, other than such as he is at the time of consent lawfully bound to suffer, as an inducement to the promisor, is a good consideration for a promise."

The term "good consideration" as employed in this section is not used in the ancient technical sense, as that of blood or natural affection, but as equivalent to the term "valuable consideration."

> *Aden v. City of Vallejo* (1903) 139 Cal. 165, 168; 72 Pac. 905, 906.

Tested by the definition of a valuable consideration given in *Section 1605 of the California Civil Code,* as construed in the *Aden case* above cited, there was a good and valuable consideration moving from Mrs. Gaylord to Mr. Gaylord for his joining in the trust and executing the declaration thereof and contributing his 5000 shares to the trust, and, on the other hand, there was a good and valuable consideration moving from Mr. Gaylord to Mrs. Gaylord for her joining in the trust and executing such declaration and contributing her 2000 shares to the trust. It was not created without a valuable consideration pass-

ing to each of the trustors therein named or without a legal obligation definitely and irrevocably binding each of them to the other, but was supported by and founded on a good and valuable consideration as statutorily and judicially defined in California. Each of said parties was acting independently with respect to his or her own property and estate. Before such mutual understanding and agreement had between them neither was obligated to give up in trust or otherwise any part of the stock so owned, but by such agreement each did agree, to such party's own prejudice, to part with valuable property by transferring the same to an irrevocable trust on stipulation that the other party would do likewise. There is here not one trustor but there are two independent trustors who pursuant to an understanding between them surrendered and gave up, irrevocably according to their common intention, something of great value which neither of them was obligated to part with. If there is not manifest a good and valuable consideration in this situation then the definition of such consideration hereinbefore given is meaningless. What the parties did is a typical example of what would constitute a good and valuable consideration, and the trust which resulted therefrom is consequently founded upon and created with such consideration and, the principle laid down in the *Touli* case governing, is not within the letter or spirit of said *Section 2280*.

The Tax Court ignores all of this and disregards the legal effect of the undisputed precedent mutual agreement of Mr. and Mrs. Gaylord for the creation by them of an irrevocable trust. It treats the situation as if each of them was acting alone in forming the trust and making his or her contribution thereto without ever being ob-

ligated to the other to do so. But the fact that the trust was created only pursuant to a previous mutually onerous and binding agreement cannot be disregarded. It was this contract which changed what might otherwise have been a voluntary trust (as that term is used in equity jurisprudence and in the amendment to *Section 2280 of the California Civil Code*) into a trust created for or founded upon a good and valuable consideration. The circumstance that from the standpoint of the beneficiaries the transaction was a gift to them is immaterial. It is the contractual relationship of the trustors and what they did as between them which is determinative of the conclusion that the trust is not such a "voluntary trust."

While on this subject, another reason may be noted why said *Section 2280* is not applicable to the trust here involved: It is the circumstance that such section contemplates a revocation "by the trustor by writing filed with the trustee," or a situation where the trustor is, as it were, outside the trust and the trustee is a person or party different from and other than the trustor. The "writing filed with the trustee" is the only method of revocation provided for in said *Section 2280* of a voluntary trust there referred to. This method would not be applicable to the trust in the case at bar where the trustors are the same persons as the trustees Mr. and Mrs. Gaylord.

The 1931 amendment to *Section 2280* is in derogation and limitation of the common law of trusts under which where a power of revocation, change or modification is not expressly reserved the trust is *ipso facto* irrevocable and for a trust to be irrevocable there is no need of the instrument creating the trust to so state. However, that statutory amendment apparently has very limited applica-

tion, because under long established law of California a trust of personal property, such as the stock which formed the original corpus of the trust in this case, may, as hereinafter pointed out, be purely oral and needs no writing, no matter how valuable the trust estate may be.

It may be further remarked that a careful reading of said *Section 2280* as so amended reveals another peculiarity which may provide a clue to the purpose of the legislation embodied in the 1931 amendment. It will be observed that elsewhere in *Title VIII*, treating of trusts, in *Part IV of Division Third* of the California Civil Code, where a personal pronoun is used with reference to a trustee it is always the masculine personal pronoun "he" or "his," not the neuter pronoun "its," which makes its first appearance in the amendment to *Section 2280* wherein the masculine personal pronoun customarily used elsewhere in the title is not used. Having in mind certain situations which may be deemed to have required remedy, it may be concluded that the purpose of the amendment was especially to govern voluntary trusts (as construed and defined by judicial decision) created with corporate trustees, such as banks or trust companies. To such trustees the neuter pronoun "its" would be appropriate. Such trusts made with such corporate trustees by laymen trustors not skilled in law are very common. But the layman trustor, through ignorance of the requirement that unless the instrument expressly reserves to him the right of revocation, modification or change the trust would not be revocable, may frequently be at disadvantage when, it not being his intention to create an irrevocable trust, he later learns that his omission to include in the instrument provision for such revocation has by law deprived him of that power. Such situation, involving layman's

ignorance of law when dealing with a bank or trust company versed in its rights and obligations, might well have been inducement to the legislature to enact the referred to amendment. It would give such a trustor, who without good or valuable consideration creates such a voluntary trust with a corporate trustee, intending in so doing to have the right to revoke the trust when he saw fit, opportunity to do so. His original intent to have the right to revoke would be given effect The amendment of 1931 to said *Section 2280* was doubtless aimed at this objective.

(b) *The Original and Unchanged Understanding, Purpose, Intent and Belief of the Parties Thereto That the Trust Was Always to Be Irrevocable Had the Effect of Supplying Any Scrivener's Omission to Include in the Original Declaration of Trust Dated November 7, 1935, Express Words of Irrevocability and Therefore Such Declaration of Trust Must Be Deemed in Any Case, as of the Time Such Trust Became Effective, Corrected in Such Respect and Read as Though it Did Contain Expression of Irrevocability.*

Even if it be assumed, for purpose of argument only, that the trust provided for in said declaration of trust dated November 7, 1935, is a "voluntary trust" within the scope and meaning of said *Section 2280* (an assumption justified neither by the fact nor the law) failure of the declaration of trust to contain express provision that the trust there provided for was or should be irrevocable was due solely to error, oversight, mistake or ignorance of the trustors Mr. and Mrs. Gaylord, as their mutual intention always was to create and provide for an irrevocable trust.

The Tax Court expressly found that

> "When requesting counsel to prepare the trust instrument, Gaylord told him that he and Mrs. Gaylord desired to form an irrevocable trust with respect to the stock. At the time the petitioners signed the trust instrument they were advised by counsel that the trust was irrevocable * * *. On February 4, 1936, the petitioners filed gift tax returns, prepared by Gaylord, for 1935, in which they reported the creation of an irrevocable trust and the transfer thereto of the above mentioned shares of stock in Marathon Paper Mills Co." [Findings, Tr. p. 196.]
>
> "The record shows, and we have found as a fact, that the petitioners had in mind the making of a complete and irrevocable grant to trust. We also think it apparent that their counsel who drew the trust instrument so understood, and the respondent has conceded that when counsel drew the instrument he did not know of the 1931 amendment to Section 2280." [Findings, Tr. p. 202.]

For many years, ever since 1872, *Section 1640* of the same Civil Code in which the above mentioned *Section 2280* is found has provided that

> "When, through fraud, mistake, or accident, a written contract fails to express the real intention of the parties, such intention is to be regarded, and the erroneous parts of the writing disregarded."

And in this connection may be noted the provisions of *Section 3399* of the same code that

> "When, through * * * a mutual mistake of the parties * * * a written contract does not truly express the intention of the parties, it may be revised, on the application of a party aggrieved, so

> as to express that intention, so far as it can be done without prejudice to rights acquired by third persons, in good faith and for value."

and the provisions of *Section 3401* of the same code that

> "In revising a written instrument, the court may inquire what the instrument was intended to mean, and what were intended to be its legal consequences, and is not confined to the inquiry what the language of the instrument was intended to be."

These code sections, which similarly have been in force without change since the enactment of the codes, are declaratory of part of the well-settled principles administered in equity where there is question of mistake of fact or of law. The intentions of the parties to a contract are to be fulfilled and any mistake of such parties which would defeat such intentions should, in equity, be corrected, so as to carry them into effect, whether it be a mistake of law or a mistake of fact and without reference to the principle that mistake or ignorance of the law does not excuse.

> *Holmes v. Anderson* (1928) 90 Cal. App. 276, pages 281 *et seq.;* 265 Pac. 1010, 1012 *et seq.*

Though the above quoted *Section 1640 and 3401* of the Civil Code were cited to the Tax Court in argument and brief [Motion for Reconsideration, Tr. p. 233] of petitioners, it completely ignored these plain legal mandates and no reference thereto is found in its findings or opinions.

In a leading case on the construction and application of the above mentioned *Section 1640* of the Civil Code,

Harding v. Robinson (1917), 175 Cal. 534, 541 to 542; 166 Pac. 808, 811, the California Supreme Court, in its opinion, after quoting said section, proceeds:

> "In this it is to be noted that the mistake arises from a failure of the contract to express the real understanding and agreement of all parties to it. That failure may arise through fraud, but this character of fraud is not fraud perpetrated to induce the contract but a fraud whereby the terms as agreed upon by the parties are suppressed or misrepresented *precisely as they may be omitted or misstated by error or oversight called in that section 'mistake or accident'.*" (175 Cal. at page 541; 166 Pac. at page 811.) (Italics inserted.)

Further on in the same paragraph it is explained that the aforementioned exceptions are to be applied where it appears that there is

> "mutuality of the mistake, that the minds of the contracting parties met, that they agreed upon a certain thing which was to have been embodied in their contract, and that by a mistake it was either fraudulently or inadvertently omitted." (175 Cal. at page 542; 166 Pac. at page 811.)

The parol evidence rule itself, as expressed in *Section 1856 of the California Code of Civil Procedure*, is expressly made inapplicable "Where a mistake of imperfection of the writing is put in issue." The inapplicability of the parol evidence rule to situations where the contract through mistake or accident fails to express the real intention of the parties is further noted in *Rottman v. Hevener* (1921), 54 Cal. App. 474, 478, 202 Pac. 329, 331; and *Estes v. Delpech* (1925), 73 Cal. App. 643, 646-647, 238 Pac. 1085, 1086.

Reformation or revision has the effect of causing the instrument as reformed to read and operate as of its original date. Reformation does not proceed upon the theory that a written contract may be altered or modified by extraneous parol testimony, but upon the theory that equity will conform a written contract which fails to express the intention of the parties to the actual one entered into by them.

> *Gardner v. California Guarantee etc. Co.* (1902), 137 Cal. 71, 69 Pac. 844.

And where basis for revision on ground of mutual mistake is present, it is obvious that the parties themselves without resort to court may reform the contract in accordance with their prime intentions and if so reformed it speaks as of its original date.

> *Ward v. Waterman* (1890), 85 Cal. 488, 24 Pac. 930;
> 22 *Cal. Jur.*, page 748;
> 53 *C. J.*, page 1055.

Applying the principles expressed in the above mentioned code sections and cases and similar authorities to the declarations of trust dated November 7, 1935, it would be a species of fraud or inequity if because of any lack in the trust declaration of express statement that the trust was irrevocable—a statement which was inadvertently omitted—either of the trustors Mr. Gaylord or his wife, who had mutually agreed upon an irrevocable trust, should seek to take advantage of the mistake which consisted in such inadvertent omission and because of it try to revoke the trust. If through their mistake or that of counsel who drafted the declaration of trust there was omission in the latter of expression of irrevocability such

mistake would not at any time make the trust revocable, and there is no rule of law which would prevent the trustors from insisting upon their mutual true original and unchanged intention and having it recognized and effectuated.

But the Tax Court not only ignored *Sections 1640 and 3401 of the California Civil Code* but held, contrary to California law, that *Section 3399* of that code, above quoted from, had no application to the trust at bar. [Findings, Tr. pp. 202 to 204, 205.] The argument advanced by the Tax Court for this holding is that "section 3399 has no application to a purely voluntary deed," citing *Enos v. Stewart*, 138 Cal. 112, 70 Pac. 1005, and *Robertson v. Melville*, 60 Cal. App. (not Cal. as cited by the court) 354, 212 Pac. 723. [Findings, Tr. pp. 203-205.] From the supposed non-application of *Section 3399* to a "voluntary deed" the Tax Court apparently draws the conclusion that such code section is likewise inapplicable to petitioners' agreement and trust. But this conclusion does not follow.

In the first place, the original declaration of trust dated November 7, 1935, is more than a deed or conveyance such as was involved in the *Enos* or *Robertson* case. Such declaration is also a contract and evidence of a contract between the petitioners, the two trustors and trustees therein named, as between themselves and with respect to the beneficiaries designated in the trust. Though as to such beneficiaries it had the aspect of a gift, the trust itself was not formed by a single donor acting alone but was the object and result of a precedent agreement or contract by which two persons, neither of whom could theretofore have been compelled by the other to make such

gift, did bind himself and herself legally and effectively to the other to make it, thereby creating a legal obligation or burden in favor of his or her co-trustor. It is not the resulting gift to the daughters and their issue which should be considered but rather the mutual and reciprocal agreements of their parents. Analogy is found in the well-known pledge to contribute to a charity: the latter is the donee of a gift yet the pledge may be enforceable legally as between the multiple pledgors.

In the second place, *Enos v. Stewart* involved the special situation of a deed of gift from a mother to her daughter in disinheritance of the former's husband. Though the Tax Court in its decision of the case at bar quotes at length from the opinion of Commissioner Cooper in the *Enos* case [Findings, Tr. pp. 203 to 204] that part of the Commissioner's opinion which is omitted from the midst of such quotation is not without its pertinent significance and explains why the court there declined to reform as against the surviving husband heir the deed to the daughter. Quoting from the omitted portion:

> "The equities of respondent are, at least, equal to those of appellant. It is the dictate of equity and natural justice that the property of a wife dying without issue should go in part to her surviving husband. This was certainly the view of the legislature in enacting our statute of distributions, for in such case it makes the husband the owner of one-half the property. If this be so, then equity would say to appellant that she should allow his respondent one-half of his property." (138 Cal. 112 at p. 114, 70 Pac. at p. 1006.)

The *Enos* case lays down no rule and expresses no principle which in any manner militates against petitioners'

position in the proceedings at bar, that by virtue of said *Section 3399* the trust created by them is and should be considered, in accordance with their original and unchanged understanding, absolutely irrevocable by either of them or any party whomsoever.

In the *Robertson* case the District Court of Appeal affirmed a judgment reforming the deed there involved in accordance with the original intention of the parties to the contract in pursuance to which the deed was executed. Presiding Judge Finlayson in the opinion in that case, after saying

> "It may be conceded that equity will not reform a purely voluntary deed, for one who accepts another's bounty cannot be heard to say that something else should be given" (citing *Enos v. Stewart*)

continues:

> "But a valuable consideration, however small, will support a conveyance; and a consideration which will support a conveyance ordinarily is sufficient to entitle the grantee to maintain an action to correct a mutual mistake in the deed." (60 Cal. App. 354, at 356-357; 212 Pac. 723, at 725.)

In the case at bar there was under *Section 1605 of the California Civil Code*, hereinbefore quoted, and its settled construction such a valuable consideration supporting the mutual agreement or contract of the petitioners pursuant to which the gift in trust was made.

In the third place, in holding said *Section 3399* inapplicable to the trust the Tax Court overlooks the circumstance that it is not any of the beneficiaries of the trust, the donees, who were before the court insisting upon ap-

plication of that section but it is the two contracting parties themselves, the petitioners herein, both of whom invoked the statute's corrective protection. There is here no case of hearing "one who accepts another's bounty" saying "that something else should be given." Those who speak here are not donees but donors and contractors, each of whom was by reason of onerous legal obligation, founded upon a valuable consideration, bound to the other to create the irrevocable trust and make his or her contribution thereto.

In the fourth place, if wrongfully and contrary to the undisputed facts of the case at bar as to the inception of that trust and the subsequent acts and conduct of the petitioners and others with respect thereto, the original declaration of trust be regarded merely as a "voluntary" deed or conveyance, as such term is used in equity jurisprudence, then it still does not follow that it is not subject to reformation or will not be regarded at all times as reformed and reading in accordance with the positive original intention of the parties thereto. See Annotation in *69 A. L. R.* at page *423, et seq.* There (on page 424) it is declared with respect to the supposed general rule that a court of equity will not reform a conveyance which is voluntary and based on no consideration:

> "As is apparent from an examination of the cases which follow, however, no such broad and sweeping rule can be laid down on this subject. Whether or not equity will reform a voluntary conveyance depends upon who seeks the reformation and against whom it is sought, as well as upon other circumstances. For example, it is well settled * * * that the grantor is entitled to a reformation of his voluntary deed as aganist the grantee * * * In

its present form and without radical limitations, the general statement set out above, taken with all its implications, is not only valueless as a guide in the determination of any given case, but is positively misleading."

Nor, while on this subject of interpreting and applying the trust according to the true intent and purpose of the parties thereto, should those maxims of jurisprudence enacted into law by *Section 3509 of the California Civil Code* be overlooked:

> "When the reason of a rule ceases, so should the rule itself" (*Section 3510*, of the same code);
>
> "One must not change his purpose to the injury of another" (*Section 3512* of the same code)

as would be the case if Mr. and Mrs. Gaylord or either of them sought to revoke the trust with resultant injury to its beneficiaries:

> "No one should suffer by the act of another" (*Section 3520* of the same code)

as would happen if the trustors and beneficiaries of the trust were penalized for the inadvertent omission of a scrivener, contrary to their intention and purpose, in drafting an instrument pertaining to the trust:

> "For every wrong there is a remedy" (*Section 3523* of the same code)

which would not be if *Sections 1640, 3399 and 3401 of the same Civil Code* were not to apply to correct or rectify a patent and undisputed error of omission in the drafting of the original declaration of trust:

> "The law respects form less than substance" (*Section 3528 of the same code*)

which would not be so if the amendment to *Section 2280* were applied arbitrarily to subvert the trustors' intent and purpose and the force and effect of the facts relating to the administration of the trust, or to single out the original declaration dated November 7, 1935, as the sole instrument to be relied upon in disregard of the written declarations of irrevocability contained in the gift tax returns executed at a somewhat later date but as a part of the same trust transaction;

> "That which ought to have been done is to be regarded as done in favor of him to whom, and against him from whom, performance is due." (*Section 3529 of the same code*)

and according to which the beneficiaries of this trust have had at all times the right to insist upon adherence by the trustors to their original intent and purpose of creating and administering for such beneficiaries an irrevocable trust; and

> "Contemporaneous exposition is in general the best" (*Section 3535 of the same code*)

a principle of large applicability to the instant case.

(c) In any case sufficient and effective expression or declaration that the trust is irrevocable is found in each of the gift tax returns signed and made under oath by each of the trustors in 1936, shortly following upon and in connection with the trustors' making of such declaration of trust and in which gift tax returns the trust was referred to and a copy of the declaration of trust filed therewith as a part thereof

Though the Tax Court expressly finds as follows:

"On February 4, 1936, the petitioners filed gift tax returns, prepared by Gaylord, for 1935, in which

> they reported the creation of an irrevocable trust and the transfer thereto of the above mentioned shares of stock in Marathon Paper Mills Co., sometimes hereinafter called Marathon. Mrs. Gaylord reported the 2000 shares of stock contributed by her as having a value of $50,000, but, by reason of exclusions and the specific exemption taken, she reported no gift tax liability. Gaylord reported total gifts in the amount of $140,278.08, of which $125,000 was reported as the value of the 5000 shares of Marathon stock contributed by him to the trust. After taking exclusions totaling $15,000 and a specific exemption of $50,000, his return showed a gift tax liability of approximately $2,500, which he paid. Subsequently in 1936 Gaylord paid an additional gift tax of approximately $100.00 with respect to said return." [Findings, Tr. pp. 196 to 197]

and also, in connection with the Tax Court's opinion on petitioners claim of estoppel,

> "that petitioners in 1936 filed their gift tax returns for 1935, in which they referred to the trust as an irrevocable trust, that the tax shown on the returns was paid and has never been refunded" [Findings, Tr. p. 205]

and though Mr. Gaylord testified that at the time he made his above referred to gift tax return there was then in existence no trust other than the trust created by the declaration dated November 7, 1935, to which he was a party or to which he had contributed, and that said trust was the only trust in existence so far as he was concerned, and that it was the trust he referred to in answering "Yes" in the return to the question therein "By the creation of an irrevocable trust for the benefit of another" [Tr. pp. 357 to 358, 360] and though Mrs. Gaylord testi-

fied that there was no other trust in existence at the time she signed her gift tax return than the trust of November 7, 1935 [Tr. p. 544] and though none of the aforementioned evidence was in any manner impugned or contradicted the Tax Court, as indicated by silence in its opinion, completely overlooked or ignored the effect of the express statements in writing, signed and sworn to by Mr. and Mrs. Gaylord in their respective gift tax returns, made and filed in connection with their creation of the trust provided for in their declaration of trust dated November 7, 1935, and as a part of the same transaction, that such trust was irrevocable. Not only was the trust of which the terms, conditions, uses and purposes were set forth in said declaration, the only trust then in existence and the only one to which by any possibility any such reference expression or designation in those gift tax returns of irrevocability could pertain, but, to put the matter beyond doubt, there was furnished to the Collector of Internal Revenue with each of said gift tax returns a copy of the declaration of trust dated the 7th day of November, 1935. Whatever may have been the effect prior to the making and filing of such gift tax returns of any omission in the declaration of trust dated November 7, 1935, of an express statement that the trust provided for therein was irrevocable, such omission was cured for all purposes by the written expressions of irrevocability incorporated in such gift tax returns made shortly (within less then two months) after the signing and acknowledgment on December 11, 1935, by Mr. and Mrs. Gaylord of the declaration dated November 7, 1935, and in connection with and as a part of the same transaction in which the trust was set up.

In any event such gift tax returns, so signed and sworn to and expressing the intent and purpose of the trustors

and trustees, Mr. and Mrs. Gaylord, that such trust was irrevocable, should, if not considered a part of the original transaction setting up the trust, be regarded as a correction, amendment or modification of the provisions of the trust as set forth in the declaration dated November 7, 1935, making such trust at all times thereafter irrevocable, if the same were not irrevocable from its very inception. Obviously, if the trust as originally established was under any theory revocable by the petitioners or either of them, it would also be subject to subsequent change or modification by them, and if they in writing did so change and modify such trust by declaring the same to be irrevocable it would, in such case, be irrevocable from that time on. Viewed, therefore, as a subsequent correction, change, modification or addition to the original trust, the formal declaration in writing by Mr. and Mrs. Gaylord, set forth in their gift tax returns, that the trust was irrevocable, served to make such trust irrevocable in any case from the time of the making of such statement of irrevocability.

That the declaration or instrument creating the trust may consist of more than one document or of any number of documents, which need not be contemporaneous in time nor have any particular formality see

> *Spalding v. Spalding* (1925), 75 Cal. App. 569, 580; 243 Pac. 445;
>
> *Lynch v. Rooney* (1896), 112 Cal. 279; 44 Pac. 565;
>
> *Taber v. Bailey* (1913), 22 Cal. App. 617; 135 Pac. 975;
>
> 65 *C. J.*, p. 275 (Trusts, Section 57.).

The declaration of trust need not be contained in the instrument which transfers the legal title but may be set out in a separate instrument or several papers or instruments

provided they are related to and connected with each other and when construed together evidence the existence of the trust.

65 *C. J.*, p. 262 (Trusts, Section 42).

Where there are two or more instruments creating, defining or relating to a trust they may be construed together to effectuate the intention of the creator, as where one instrument incorporates another by reference.

65 *C. J.*, p. 500 (Trusts, Section 247).

Moreover, where the trust is insufficiently declared and afterwards the declaration is made sufficient by the trustor, the subsequent declaration relates back to the original There is no particular formality required or necessary in the creation of a trust. Where the existence of a trust is proved, proof by way of such recitals as those in the gift tax returns above mentioned, no matter how late in time, will relate back to the creation of the trust.

Union Trust Company of Pittsburgh v. McCaughn (D. C. E. D. Penn., 1927) 24 Fed. (2d) 459, 462.

No set form of words is necessary to create a trust.

Tabor v. Bailey (1913), 22 Cal. App. 617, 620; 135 Pac. 975.

That the irrevocable character of the trust created by them was in the minds of Mr. and Mrs. Gaylord when they made their income tax returns needs no argument in support and is emphasized by the circumstances that the entries in those returns were made by Mr. Gaylord in his own hand. In view of their original and unchanged intention to create an irrevocable trust and their understanding that they had formed such a trust, it is immaterial that

when they made, signed, verified and filed their gift tax returns, neither Mr. nor Mrs. Gaylord anticipated the need of any additional declaration of irrevocability.

(d) *The execution by Mr. and Mrs. Gaylord, signed and acknowledged and made under oath by each of them of the* Declaration Being a Part of a Certain Declaration of Trust Dated November *7, 1935, whcih is dated that date but was not recorded until March, 1940, wherein they certify and declare that the trust provided for in said declaration was always intended and is intended by them to be and is and shall always be absolutely irrevocable, which statement was so made under oath by the trustors and trustees, Mr. and Mrs. Gaylord, long before any issue or controversy was intimated, suggested or raised by any tax authority based upon the claim that the trust was irrevocable and was so made out of an abundance of caution promptly upon omission in said declaration dated November 7, 1935, of an expression of irrevocability being called to Mr. and Mrs. Gaylord's attention, is again a sufficient and effective expression or declaration relating back for all purposes to the very inception of the trust, that the trust always was and is irrevocable.*

However, at no time prior to early in the year 1940 did either Mr. or Mrs. Gaylord have any idea other than that the trust was absolutely and for all time irrevocable. It was only on question being raised by their counsel in the early part of 1940 and because of it that the supplemental Declaration Being a Part of a Certain Declaration of Trust Dated November 7, 1935, was prepared, signed, sworn to and acknowledged. [Mr. Gaylord's testimony, Tr. pp. 363 to 365.]

The Tax Court expressly found that it was at the instance of their counsel who drafted it as soon as he learned of the 1931 amendment to *Section 2280 of the California Civil Code* that the petitioners on March 27, 1940, signed and acknowledged such supplemental instrument and after so signing and acknowledging left it with their counsel, and that thereafter it was recorded in Los Angeles and Calaveras counties, California, on March 28, 1940, and May 14, 1940, respectively. [Findings, Tr. pp. 198 to 199, 202.] Except for a quotation from its provisions, no other reference is made by the Tax Court in its Findings and Opinions to this supplemental declaration or to the fact that it was under oath and made in good faith by the trustors and trustees of the trust and is bona fide evidence of their original and continuing intent and purpose to create an irrevocable trust in 1935, an intent and purpose with which all their acts have at all times since the trust's inception been consistent. Although, in view of all facts and circumstances hereinbefore related, it was not necessary to have had made and recorded in March, 1940, such supplemental statement reaffirming and redeclaring the trustors' and trustees' original and never changed intention that the trust was and should be forever irrevocable, abundant caution dictated such course. The existence of the trust in 1935 having been proven, expression of irrevocability by way of such recitals as those in such supplemental declaration, no matter how late in order of time, will relate back for all purposes to the creation of the trust.

> *Union Trust Company of Pittsburgh v. McCaughn*, above cited.

Incidentally, such supplemental statement was never recorded in Texas or elsewhere outside of California for

the simple but sufficient reason that outside the latter jurisdiction the original declaration of trust dated November 7, 1935, was, in form as written and without more, sufficient under any circumstances and for all purposes to evidence the creation in 1935 of an irrevocable trust on the terms and conditions and for the uses and purposes set forth in that declaration.

(e) *The declaration of trust dated November 7, 1935, shows on its face that it was to be operative under laws of jurisdictions other than California, and under the law of every jurisdiction in the United States outside California the trust set forth in said declaration in the form there stated would, without more, at the time said declaration was executed, be irrevocable.*

A reading of the trust declaration itself shows this to be true and that neither the use of that instrument nor the operation of the trust was ever intended to be limited to California. Not only is no such limitation expressed in or to be implied from the document itself and not only are the trustee's powers under the trust sufficiently broad to permit of investment of the trust's funds and its operation anywhere within or without California, but the very fact that The Northern Trust Company, of Chicago, Illinois, was named in said declaration as successor trustee indicates that the trust therein provided for was intended to be nation-wide in scope, and since such trust in form so declared would be irrevocable everywhere outside of California it must be assumed that it was also intended by the trustors to be irrevocable within that state.

The Tax Court in its Findings and Opinions makes no mention of the fact that The Northern Trust Company, a corporation foregin to California, was named in the

declaration dated November 7, 1935, nor of the fact, in undisputed evidence [Mr. Gaylord's testimony, Tr. pp. 355, 381] that no proceeds of sale of the Marathon Paper Mills stock of the trust were ever kept in or came to California except such thereof as were invested in California real estate.

That said declaration of trust, in the form in which it was then written and without the expressions of irrevocability contained in the gift tax returns and in the supplemental declaration, was sufficient to create, an irrevocable trust in jurisdictions outside of California see

Bogert, The Law of Trusts and Trustees (1935), Vol. 4, Sec. 993, page 2891, and cases there cited; and

Restatement of the Law of Trusts, as adopted and promulgated by the American Law Institute (1935), Sections 330 and 331;

and as to Illinois,

Massey v. Huntington (1886), 118 Ill. 80; 7 N. E. 269;

Trubey v. Pease (1909), 240 Ill. 513; 88 N. E. 1005;

Hubbard v. Buddemaier (1928), 328 Ill. 76; 159 N. E. 229;

and as to New York,

Marvin, et al v. Smith, et al, (1871), 46 N. Y. 571;

Gillman v. McArdle (1885), 99 N. Y. 451; 2 N. E. 464;

Smith v. Title Guarantee & Trust Co. (1942), 287 N. Y. 500; 41 N. E. (2d) 72;

and as to Texas,

Monday v. Vance (1899), 92 Texas 428; 49 S. W. 516.

(f) *Many of the operations and transactions of the trustees of the trust since its inception have been outside of California and in jurisdictions where the trust has always been absolutely irrevocable.*

The Tax Court not only appears to have overlooked the effect of the extent and scope of the operation of the trust as revealed in and indicated by the trust declaration of November 7, 1935, itself, but as well to have disregarded the effect of the acts and conduct of the trustees under the trust in jurisdictions outside of California where the trust has always been irrevocable.

First, there is the matter of the investments in Texas real property and the rents therefrom. While the Tax Court does note in its findings that

> "In 1938 the trustees made certain purchases of real estate situate in Texas, totaling about $90,000, and in connection therewith had the trust instrument recorded in four counties in that state" [Findings, Tr. p. 197]

it completely failed to take cognizance of the undisputed fact that under Texas law, as shown by such authorities as above cited, and others which could be adduced, the trust as set forth in the declaration dated November 7, 1935, was, without more, absolutely irrevocable in Texas and that, its law governing as to the real property there located belonging to the trust, the rents of such property included in the 1938 and 1939 fiduciary returns of income for the trust should in any case be treated as income of an irrevocable trust which was distributed by the trustees, in the years in which it was received, to the beneficiaries and was chargeable to the latter and under no circumstance to the trustors. No mention of these rents is made anywhere in the Tax Court's Findings or Opinions.

Secondly, there is the matter of the sales of Marathon Paper Mills stock made by the trustees in Illinois and New York. Though Mr. Gaylord testified positively and without contradiction that "all of which sales took place, of the entire 7000 shares, in the City of Chicago, Illinois, and the City of New York, New York" [Mr. Gaylord's testimony, Tr. p. 355] the Tax Court in its Findings and Opinions makes no reference to the place of sale but simply states that "For convenience in making delivery upon sale, certificates were sent from time to time to a bank in Chicago, in which the proceeds of all sales were deposited in an account in the names of the petitioners as trustees" [Findings, Tr. p. 197].

Thirdly, there is the undisputed fact that all cash funds of the trust in the years 1936, 1937 and 1938, were kept in the names of Mr. and Mrs. Gaylord as trustees under the declaration of trust dated November 7, 1935 with Harris Trust & Savings Bank, Chicago, Illinois, and in the year 1939 all of the bank accounts the trust were kept with that bank and with Bankers Trust Company, of 16 Wall Street, New York, New York. [Mr. Gaylord's testimony, Tr. p. 355, 381.] The only reference by the Tax Court in its Findings and Opinions to the places of deposit of the trust funds in the years mentioned is as just above quoted.

As there is no jurisdiction outside California where it would even be possible to question the irrevocable character of this trust during the years 1936 through 1939, and as the trustees' acts in disposing of trust assets without California and investing their proceeds serve to mark them and such investments as belonging to an irrevocable trust (the acts of the trustees being subject to the laws of the jurisdiction in which the same were performed) and as all original assets of the trust, the 7,000

shares of Marathon Paper Mills stock, were under the trust sold by its trustees in Illinois and New York (in which jurisdictions the trust was then irrevocable) and the proceeds of such sales and the trust's bank accounts were maintained in the last two mentioned states, it follows that even though it could possibly be argued that the stock originally contributed to the trust came to it as to a revocable trust, the trustees' conduct in dealing with those shares in other jurisdictions in which the trust was also intended to operate and in which the same was at all times irrevocable converted those shares and all proceeds thereof, in whatever form the same might be in the future, into assets of an irrevocable trust.

A bank account is, of course, nothing more than a chose in action, a contract, and such contracts are ordinarily governed by the law of the place where they are made and intended to be performed. The trustees, by transacting business under a trust which in form was sufficient to create—and, indeed, was at all times intended to create—an irrevocable trust in the jurisdictions (Illinois and New York) in which such contracts (bank accounts) were made, emphasized the trust's irrevocability; for they so contracted and did business with the information, belief and knowledge that they were acting for a trust irrevocable under the laws of those jurisdictions.

In the years 1936 through 1939 the only assets of this trust were proceeds of the sales of the above mentioned stock and properties acquired for the trust by investment of some of those proceeds. As the latter, by reason of the dealings had by the trustees with respect thereto and to such stock in jurisdictions where the trust was irrevocable, had been impressed with the character of belonging to

such a trust, the investment of such proceeds in any jurisdiction, even in real estate in California, could not affect or change their status as belonging to an irrevocable trust but would pass it on to property so acquired with such proceeds. All such property would then be held by the trustees in an irrevocable trust on the terms and conditions and for the uses and purposes set forth in said declaration dated November 7, 1935. Removal over state lines of trust assets representing proceeds of such original stock sales would not change the character of such assets as belonging to an irrevocable trust.

(g) *Under the Laws of California the Trust of the Stock Referred to in Said Declaration of Trust Dated November 7, 1935, Formed by Mr. and Mrs. Gaylord for the Benefit of Their Daughters and Their Living Issue, Has at All Times Since Its Inception in 1935 Been Valid in Any Case as an Oral Irrevocable Trust of Personal Property Which Needed No Writing, and the Proceeds of the Stock Constituting the Corpus of Such Trust, No Matter How Subsequently Invested or in What Form Transmuted, Always Remain Subject to Such Oral Irrevocable Trust.*

Despite any provision of the 1931 amendment to *Section 2280 of the California Civil Code,* it has never been required that a trust of personal property, such as shares of corporate stock, be in writing, but the same may be formed by a purely oral declaration, understanding or agreement.

Booth v. Oakland Bank of Savings (1898), 122 Cal. 19, 54 Pac. 370;

Hellman v. McWilliams (1886), 70 Cal. 449, 11 Pac. 659.

It is obvious from reading *Section 2280* that it does not refer to oral trusts, no matter what or how much the trust estate includes. Such a trust can still be created, and unless in its creation there is expressly reserved power of revocation, change or modification, the trust is neither revocable nor can be changed nor modified. Such was the case in the years 1935 to 1939 and thereafter.

Where, as here, the trustors and trustees had an oral intent, purpose, understanding and agreement for creating an irrevocable trust covering the 7000 Marathon Paper Mills shares the circumstances that later they executed a declaration of trust setting forth more explicitly certain terms and conditions upon which and uses and purposes for which such stock and its proceeds were to be held by the trustees does not prevent them from showing that such trust, dating back to the original oral understanding and agreement, was intended always to be irrevocable. Because the written declaration is entirely silent upon this subject and contains no statement either way, the provision for irrevocability still subsists. It is, therefore, a proper situation for introduction of parol evidence to explain rather than contradict the written instrument, and in such case oral statements of the trustors and trustees made before and after such execution of the written declaration of trust may be considered as well as conduct of the parties affected by the instrument in performance under it.

65 *C. J.*, pp. 500 to 502 (Trusts, Sections 248 and 250).

The Tax Court refers briefly in its Findings and Opinions to this alternative contention of the petitioners and says:

> "The obvious answer to that contention is that the record fails to show that there was ever any intention to create an oral trust, irrevocable or otherwise, or that any oral trust was, in fact, created. The only trust created was the written trust described in our finding of fact, and is that trust, and not some other trust, with which we are here concerned." [Findings, Tr. pp. 204 to 205.]

To this it should suffice to reply that Mr. and Mrs. Gaylord intended and validly agreed between them to create *an* irrevocable trust—whether orally or in writing is, in a sense, immaterial—and the declaration dated November 7, 1935, merely implemented, so far as it went, such precedent agreement and did not alter or abrogate the important, to their minds, provision that such trust was irrevocable, and that the declaration's silence on that point is filled by such original and continuing express oral understanding. It might have been different if the written declaration had stipulated otherwise.

Nor should it need argument to show that where an oral irrevocable personal trust of personal property has been established real property thereafter acquired for the trust through sale of the personal property and investment of its proceeds in such real property becomes subject to the same condition of irrevocability.

II.

The Tax Court Erred in Concluding That Estoppel Is Not an Issue in This Case and in Deciding That Respondent Commissioner Is Not Estopped to Claim That the Trust Was Irrevocable.

The petitioners contended before The Tax Court that because of the making and filing in 1936 by the trustors Mr. and Mrs. Gaylord of their gift tax returns expressly referring to the trust as an irrevocable trust and the payment in that year by Mr. Gaylord of gift tax on transfers to the trust of stock which constituted the original trust estate, shown in his gift tax return, and the continued retention by the Treasury Department of the amount of taxes so paid and its failure to question until 1941 the irrevocable character of the trust and the reliance at all times by the trustors, trustees and beneficiaries of the trust upon the fact that the trust was irrevocable and upon the apparent agreement of the Treasury Department therein, respondent Commissioner is estopped from claiming or asserting that the trust ever was or is irrevocable.

If the trust provided for in the declaration of trust dated November 7, 1935, at any time was revocable or could be terminated by Mr. and Mrs. Gaylord, or either of them, neither of them was required to make any gift tax return with respect to the stock contributed to and forming the initial *corpus* of the trust estate and no gift tax was payable on any such contribution.

Revenue Act of 1932, Section 501;
Regulations 79, Article 3;
Burnet v. Guggenheim (1932), 288 U. S. 280;
Estate of Sanford v. Com. (1939), 308 U. S. 39;
Rasquin v. Humphreys (1939), 308 U. S. 54;
Com. v. Warner (C. C. A. 9, 1942), 127 Fed. (2d) 913.

However, they, believing that they had made an irrevocable trust and so declaring under oath in their respective gift tax returns that they had done so, filed such returns with the Collector of Internal Revenue in 1936 and Mr. Gaylord then paid to him the gift tax shown on his return. Mrs. Gaylord made no such payment of gift tax because of the exemption and exclusions to which she was entitled on her return. Later in the same year 1936 there was an assessment of additional gift tax against Mr. Gaylord on his return which he then paid. Because of the plain statements made in these returns and the circumstance, among other things, that there was furnished with each such return a copy of the declaration of trust referred to therein, the Treasury Department, Internal Revenue Service, had full knowledge as early as the forepart of March, 1936, that Mr. and Mrs. Gaylord claimed and believed that under the terms of the declaration of trust they had created an irrevocable trust and that they had confirmed and ratified such irrevocable character by making such returns and statements. It was not until over five years later that the Treasury Department intimated to them or that they were first advised by it that it considered the trust to be revocable. In the meantime, for the years 1936 through 1941, they and their daughters had been permitted by the Department and Internal Revenue Service to make and file income tax returns on the basis that the trust created in 1935 was irrevocable and the income therefrom was income not of Mr. and Mrs. Gaylord nor of either of them but of their two daughters. When the Department, which through all these years had retained the gift taxes paid by Mr. Gaylord with respect to his contribution to the trust in 1935, first notified either Mr. or Mrs. Gaylord of its change of attitude or position with respect to this trust Mr.

Gaylord was already precluded by running of the statute of limitations from seeking any refund of gift taxes so paid by him in 1936. Mr. and Mrs. Gaylord were permitted by the Department to conduct their affairs and those of the trust in accordance with their understanding and belief that such trust was irrevocable and were thereby lulled into a sense of security on that subject. It is their contention that the Commissioner of Internal Revenue should not now be permitted to change his position to their detriment. The Department having assessed against Mr. Gaylord and collected from him gift taxes on the basis that the trust created was irrevocable and one in which he had definitely and permanently parted with all beneficial interest in the *corpus* and income of the trust estate should not now be permitted to adopt another diametrically different and opposite position, to Mr. Gaylord's financial loss, especially in view of the continued manifest good faith of Mr. and Mrs. Gaylord and their complete reliance at all times on the irrevocable character of the trust they had created. Every consideration of justice, equity and fair dealing estops and forbids the Commissioner now to shift or change his basis for the purpose of collecting additional taxes.

To this contention the only response made by the Tax Court was that "Estoppel must be specifically pleaded; otherwise it is not an issue in the case. *Eldorado Oil Works*, 46 B. T. A. 994." It has not been pleaded here. [Findings, Tr. p. 205.]

It is submitted, however, that the estoppel contended for by the petitioners was not only sufficiently pleaded in their respective petitions to the Board of Tax Appeals but also that such issue was definitely before the Tax Court at the hearing had in these proceedings and that the

case was tried on the theory that among the issues there was this specific issue of estoppel involved.

But before looking at the record in the present proceedings it may be well to examine the Tax Court's sole citation in the above quotation from its opinion. In the *El Dorado Oil Works* case, so referred to, no facts or circumstances were either pleaded in the petition or in evidence before the Board on which any estoppel could be founded. Says the Board in its opinion there (on page 998):

> "The petitioner made representations of fact in its income tax return which were false, were known by the petitioner to be false, and were relied upon by respondent in allowing deductions which would not otherwise have been allowed."

The Board then continues (on page 999) that since

> "the estoppel was not pleaded and is not even demonstrated, we are unable to consider that there is any issue of estoppel in the case or if there is such an issue that it may be decided to the respondent's [taxpayer's?] advantage."

The Board emphasized that even in its brief the taxpayer did not point out precisely what it is that the Commissioner was estopped to deny and declared that an estoppel must be definite and certain and not vague and uncertain (46 B. T. A., at pages 998 to 999). So it appears that the *El Dorado Oil Works* case is not much, if any, authority for the broad proposition above quoted from the Tax Court's opinion herein and that in the *El Dorado Oil Works* case not only were no facts from which an estoppel could arise pleaded but no such facts were proven or offered in evidence. Moreover, the taxpayer there made in its income tax return representations of fact which

were not only false but known to the taxpayer to be false. In the case now at bar there was, of course, no misrepresentation whatever in the gift tax returns made, signed, verified and filed by the petitioners early in 1936. In those returns they declared the fact to be that the trust was irrevocable, a fact which was not only believed by them then and there to be true, but which, if by reason of some legal technicality it had not theretofore been true, was made true by the very fact of their so expressing it in writing in those gift tax returns. This significant feature the Tax Court wholly overlooked in its decision cision.

It is not necessary that for pleading an estoppel in a proceeding such as this the particular word "estoppel" be used in the petition to the Board of Tax Appeals. All that is required on the part of the petitioning taxpayers, and it is sufficient, is to plead the facts from which the estoppel arises or on which it is based. Mr Gaylord pleaded those facts in his petition to the Board [see Mr. Gaylord's said petition, Tr. pp. 27 to 29, 31 to 32, 34 to 35, 37 to 38] and Mrs. Gaylord pleaded the same facts in her petition to the Board. [See Mrs. Gaylord's said petition, Tr. pp. 117 to 119, 121 to 122, 125, 128.] In each such petition there appears as a part of the statement of the facts as to the creation of the trust, the making, signing, verification and filing of the gift tax returns, and allegations to the effect that the trustors, trustees and beneficiaries of the trust relied at all times upon its irrevocable character, and allegations that each of the daughter beneficiaries of the trust rendered their individual income tax returns of the income for the years 1936, 1937, 1938 and 1939, in which returns each of them included her one-half of the net income of the trust for the appropriate year, and paid her individual income taxes on such in-

come. In Mr. Gaylord's petition there was also included allegations as to his payment of the gift tax.

Though the words "estopped" or "estoppel" do not appear, the same if used would amount only to expression of a conclusion of law and not a statement of fact as required by the rules of the Board, now the Tax Court. Not only were facts constituting a legal and equitable estoppel so pleaded in both petitions, but the same were also proven at the hearing and in exhibits then admitted in evidence before that Court.

Indeed, it considered that the issue of estoppel was before it. Estoppel was another reason for introduction in evidence of the gift tax returns. When a photographic copy of Mr. Gaylord's gift tax return was received in evidence there was no objection on respondent's part to its authenticity but his counsel then stated:

> "if the idea is that a gift tax or payment of a gift tax is material to this case, I object on that ground as to immateriality and irrelevancy. I take it, though, Your Honor, that counsel is offering these exhibits because of the statements made therein by Mr. Gaylord in reference to the trust." [Tr. p. 360.]

As to which the court commented:

> "I don't think, in the light of counsel's opening statement on estoppel and equity you can assume that is the only purpose of the gift tax return."

After further colloquy between the court and counsel for respondent the latter stated:

> "I think under counsel's theory of the case he is entitled to have the documents in evidence. No objection." [Tr. p. 361.]

Not only are the income tax returns of the daughter beneficiaries for the four years from 1936 to 1939 in evidence but also for those years Mr. and Mrs. Gaylord's individual and fiduciary returns; there being reference made in the first of the latter (that for 1936) to the filing in the early part of 1936 with the gift tax returns of Mr. and Mrs. Gaylord of a copy of the declaration of trust dated November 7, 1935.

The Commissioner of Internal Revenue had at all times the facts and circumstances of the case before him and must be presumed to know that under the law, even though the declaration of trust originally contained no expression of irrevocability, such omission was properly and adequately supplied in the gift tax returns filed referring to this particular trust and to none other, and he has had at all times full knowledge that the parties to the trust, trustors, trustees and beneficiaries, were acting and conducting themselves in reliance upon the trust's irrevocability and were paying out money and value on that basis and changing their position accordingly, and that no gift tax need have been paid by Mr. Gaylord in 1936 or at any time if the trust had not been irrevocable. But the Commissioner kept silent, received the benefits of his silence and raised no question as to the irrevocability of the trust until years had passed and he then initiated the present controversy. In justice and equity, in view of all of circumstances and facts surrounding the conduct of all parties to this trust, the respondent Commissioner should be estopped to claim or assert that the trust ever was revocable.

III.

The Tax Court Erred in Determining That All Income of the Trust Which Was Distributed by the Trustees to and Received by the Beneficiaries of the Trust in the Years 1936 Through 1939 Was Income of Mr. and Mrs. Gaylord and Not of Such Beneficiaries.

Examination of the findings and conclusions of the Tax Court [Tr. pp. 192 to 216] shows that the reason for its holding that all the trust's net income for the years 1936 through 1939 was income of Mr. and Mrs. Gaylord in respective proportions of five-sevenths to Mr. Gaylord and two-sevenths to Mrs. Gaylord was its conclusion that the trust was revocable at all times during those four years. That such conclusion is without foundation in law or fact has, it is respectfully submitted, been demonstrated in preceding pages of this brief. It follows, therefore, that the Court erred in so determining that such income was income of Mr. and Mrs. Gaylord and in failing to find and decide as a matter of fact and of law that all such income was income of the daughter beneficiaries who reported it in their respective individual income tax returns and paid taxes assessed thereon.

IV.

The Tax Court Erred in Deciding, Contrary to Law and Fact, That Rents for the Years 1938 and 1939 of the Texas Real Property Belonging to the Trust Was Income of a Revocable Trust and Hence Income of Mr. and Mrs. Gaylord and Not of the Beneficiaries of the Trust.

While the Tax Court made no specific finding as to whether these particular rents were the income of Mr. and Mrs. Gaylord or of their daughters, it did, as shown

in previous pages of this brief, utterly disregard the petitioners' argument concerning these rents and, by not differentiating between them and other income of the trust, included such rents in the income of the trust which it held taxable to Mr. and Mrs. Gaylord. That this decision of the court is erroneous likewise follows upon proof already made that the trust from its very inception was and always remained irrevocable. But respecting these rents such error of the court was multiplied because by no stretch of argument could *Section 2280 of the California Civil Code* as amended in 1931 apply to land located in the State of Texas. It is primer law that not only is validity of a trust of an interest in land determined by the law of the state where the land is (*Restatement of Conflict of Laws* as adopted and promulgated by the American Law Institute (1934 *Section 241*) but administration of a trust of land is also governed by the law of that state (said *Restatement*, Section 243), which law likewise determines whether a person has an equitable interest in the land. (Said *Restatement, Section 239.*) It has already been shown in this brief that under Texas laws the trust declaration dated November 7, 1935, as written, and without more, sufficed to establish an irrevocable trust in that state.

V.

The Tax Court Erred in Deciding, Contrary to Law and Fact, That the Basis for Computing Gain on the Sales of Marathon Paper Mills Company Common Stock (With Exception of 100 Shares) Was $2.84276 Per Share Instead of a Minimum of $8.21 Per Share as Claimed by Petitioners.

There is no controversy as to 100 shares of Marathon Paper Mills Company common stock belonging to Mr.

Gaylord and included in the 2362 shares of such stock sold by him in 1939, which 100 shares was acquired by purchase by him in 1933 for $1,700. [See Findings, Tr. p. 211.] Other than such 100 shares, the total number of shares of Marathon Paper Mills sold by Mr. and Mrs. Gaylord and the trust in the years 1936 through 1939, was 23,412 [Findings, Tr. p. 210], which included 1408 shares resulting from the 4 for 1 split of the 352 shares acquired by Mr. Gaylord in 1927 from his brother C. W. Gaylord in exchange for 432 shares of Robert Gaylord, Inc., a transaction discussed later in this brief. A memorandum showing how the $8.21 value was determined by petitioners for all of the stock sales involved in these proceedings is set forth in Exhibit F to their respective petitions to the Board of Tax Appeals [Tr. pp. 92, 182] which Mr. Gaylord testified [Tr. pp. 366, 374-375] is corrected by Exhibits G and H to said petitions. Said Exhibit G, entitled *memorandum showing how value of stock of Marathon Paper Mills Company, owned by George S. Gaylord, is established* is set forth in the Transcript of the Record on pages 92 to 95, repeated at pages 182 to 185. Demonstration of the basis of such stock is further detailed in said Exhibit H to said petitions, entitled *Computation of Basis of Marathon Paper Mills Company Stock*, which is printed on pages 95 to 96 and again on pages 185 to 187 of the Transcript of the Record, purportedly, though erroneously, as a continuation of Exhibit G, the designation Exhibit H, used in said petitions, having been omitted in printing the transcript. Mr. Gaylord testified concerning these three exhibits and the computations shown thereon and to the correctness thereof and truth of the statements made therein. [Tr. pp. 366, 374 to 375, 379.] Said Exhibit H shows a higher cost basis per share, $10,988,

than the $8.21 per share claimed herein. [Tr. pp. 96, 186.]

It should be remembered that this evidence is unimpeached. Respondent offered nothing to counter it. The only witness placed on the stand by respondent on issues of the case involved in these present proceedings, Joseph A. Field, the Internal Revenue Agent who examined and reported on the stock transactions covered by the income tax returns in question, testified only as to the method or manner whereby the Government's figures were arrived at, and his testimony was received for that purpose only. [Field's testimony, Tr. pp. 545 to 548.] Because of his manifest lack of any personal knowledge of the facts pertaining to the 1917 consolidation and the actual values involved therein this witness made no attempt to testify on these subjects. The memorandum of computations on which the Internal Revenue Bureau reached its figure of $2.8367 per share as the cost basis of the Marathon Paper Mills stock so sold was received in evidence as respondent's Exhibit U for the sole purpose of showing the method of computation and not as evidence of the truth of any purported statement of fact contained therein. [Tr. p. 557 559.]

Petitioners' contention that, except as to the above mentioned purchase by Mr. Gaylord of 100 shares in 1939, the statutory basis for computing gain on all sales of Marathon Paper Mills stock made by them individually or as trustees in the years 1936 through 1939 is a minimum of $8.21 per share, is supported by *Section 2a of the Revenue Act of 1916* governing the Menasha Printing and Carton Company stock received by Mr. Gaylord as a result of consolidation of Menasha Carton Company and the Menasha Printing Company into the Menasha Printing and Carton

Company as of July 1, 1917. *Section 202(a) of the Revenue Act of 1926* governing the shares of Menasha Printing and Carton Company stock received by his brother C. W. Gaylord in 1927 in exchange for 432 shares of Robert Gaylord, Inc., and *Section 113(a) of the Revenue Acts of 1936 and 1938* governing the ultimate sales of such Marathon Paper Mills Company stock in the years 1936 through 1939.

The receipt by Mr. Gaylord of his common and preferred shares of Menasha Printing and Carton Company on its coming into being as a result of the consolidation of Menasha Printing Company and Menasha Carton Company in 1917, was, as to Mr. Gaylord, a taxable exchange in that year, although through inadvertence and mistake it was not so regarded by him. Though *Marr v. U. S.* (1925), 268 U. S. 536, had not yet been decided when Mr. Gaylord entered into the 1917 consolidation, the 1916 revenue act granted no exemption from income taxation to transactions connected with the reorganization, merger and consolidation of corporations.

> *Cullinan v. Walker* (1923), 262 U. S. 134;
> *Holmes Federal Taxes* (6th Ed.) pp. 655 to 656.

The Tax Court, itself, in the proceedings now on review states that "The revenue act in force at the time of the 1917 consolidation contained no provision for the non-recognition of gain in the case of corporate reorganizations or the carry-over of the basis of the old stock to the new, and the parties so agree." [Findings, Tr. p. 214.]

Under Section 2a of the Revenue Act of 1916 the cost to Mr. Gaylord of the common and preferred shares of Menasha Printing and Carton Company then received was (a) the fair market price or value (real and actual value)

of his 337 shares of Menasha Carton Company which he turned into the consolidation, plus (b) the $152,161.11 principal amount of his promissory note dated August 30, 1917, in favor of Clinedinst; said 337 shares and promissory note being given in exchange by Mr. Gaylord in and as a part of a single undivided transaction as a common consideration, undistinguished and unallocated as to any particular shares, for the 1975 shares of common and 410 shares of preferred stock of Menasha Printing and Carton Company so received by him on such consolidation. [Mr. Gaylord's testimony, Tr. pp. 367-368, 369-390, 371-372.] But Mr. Field, the Internal Revenue Agent, testifying as to the method or manner whereby respondent's figure of $2.83+ was arrived at, admitted with respect to Mr. Gaylord's 337 shares of Menasha Carton Company contributed by him to the consolidation, that he (the witness) "made no reference to the fair market value of the stock upon advice from Washington that the same did not have a valuation above cost," which was $34,436.51. [Field's testimony, Tr. p. 551.] He further testified that this cost "was allocated to the preferred and the common [of the Menasha Printing and Carton Company received by Mr. Gaylord in the consolidation for his said 337 shares of Menasha Carton Company] on the relative par value of the two stock, so that for the 190 shares of preferred there was allocated $10,468.70, and to the 435 shares of common there was allocated $23,967.80." [Field's testimony, Tr. p. 549.] Mr. Field also testified that he considered the $152,161.11 promissory note to be the purchase price of 1525 of these common shares, giving as his only reason that "From the information on the note it might be supposed that that note was to pay for 1525 shares of stock purchased from Mr. Clinedinst, and, as

such was used in my report" [Field's testimony, Tr. pp. 552-553] despite the fact that the par value of the 1525 shares was $152,500 and, as positively testified to by Mr. Gaylord—the only evidence on the subject—, there was no separate purchase of the 1525 shares as they were all lumped together, as it were, with all the other stock received by him in the consolidation as integral and inseparable parts of the same reorganization transaction. Field added that "the basic cost of $2.8367 culminates from the purchase that I have recorded here of 1525 shares for $152,161.11." [Field's testimony, Tr. p. 553.] He repeatedly stated that he regarded Mr. Gaylord's acquisition of 190 shares of preferred and 435 shares of common stock of Menasha Printing and Carton Company as an exchange for Mr. Gaylord's 337 shares of Menasha Carton Company and as a transaction separate and apart from his "purchase" for $152,161.11 of 1525 shares of common stock of the new company and not a part of the one transaction of the reorganization of the Menasha Carton Company and the Menasha Printing Company: "I considered them two separate transactions." [Field's testimony, Tr. pp. 556-557, 561.] On cross-examination he conceded that if the 1917 consolidation were a taxable reorganization the basis of the stock would properly have been the then value of Menasha Carton Company stock contributed by Mr. Gaylord. [Field's testimony, Tr. p. 553.] Previously, on direct examination, witness Field thus summed up the difference between his method whereby he had obtained the $2.83+ basis of cost for the Marathon Paper Mills stock sold and Mr. Gaylord's whereby he arrived at the $8.21 minimum basis: "Mr. Gaylord used a valuation of $350,000 for stock that I used a valuation on of $34,436.50," and that Mr. Gaylord's valuation "was

used as an apparent fair market value, supposedly, as of the date of the consolidation." [Field's testimony, Tr. p. 552.]

The Tax Court very properly repudiates the Commissioner's position that the market value of Mr. Gaylord's Menasha Carton Company stock contributed by him to the exchange was not to be considered and correctly declares the law when it says:

> "To the extent then, that Gaylord acquired preferred and common shares of stock of the Menasha Printing & Carton Co. for his 337 shares of Menasha Carton Co. in the 1917 consolidation, he realized gain or sustained loss equal to the difference between the fair market value of the shares so acquired, and his cost or other basis for the Carton Co. stock exchanged and the basis of the Carton Co. shares surrendered, adjusted by the gain or loss realized or sustained, became the basis to him of the Menasha Printing & Carton Co. shares acquired. In other words, the basis for the Menasha Printing & Carton Co. shares was the same as their fair market value when acquired." [Findings, Tr. p. 214.]

However, in applying the principle that the basis for the new company's shares was the same as their fair market value when acquired by Mr. Gaylord, the Tax Court arbitrarily disregards the undisputed evidence of Mr. Gaylord's positive and uncontradicted testimony that the consolidation was effected on the basis of the respective appraised values of the physical assets plus the book values of the quick assets of each of the two consolidating corporations used not as an indication or determination of real or actual, or fair market values, values involved but rather and only as a standard or measuring stick or rule

of thumb for arriving at the proportionate respective interests in the new company of the stockholders of each of the old companies, and that his exchange of his 337 shares of the Menasha Carton Company and his execution at the same time of his $152,161.11 note for the common and preferred stock of the new corporation received by him in the consolidation were essentially part and parcel of one integral and undivided transaction not involving any separate purchase of any stock from Clinedinst, and concludes and finds that "the fair market value of the preferred and common shares of Menasha Printing & Carton Co. stock acquired by Gaylord in the consolidation was $100 per share" and "As for the shares purchased from Clinedinst personally, that was the price actually paid." [Findings, Tr. p. 215.]

It is submitted that there is absolutely no evidence in the record of any such separate purchase from Clinedinst. As revealed by witness Field's testimony, such a supposed purchase was an unfounded and arbitrary assumption made by him (who had no knowledge of the real facts) in trying to reach as low a cost basis as possible for the Menasha Printing and Carton Company stock received by Gaylord in the consolidation.

The $100 per share assumed and found by the Tax Court to be the "fair market value" of such stock is merely the par value thereof and has nothing to do with its true value. There is no support in the evidence for this finding or for the Tax Court's unqualified statement that "One hundred dollars per share was the price fixed by the parties for the new shares in their dealings with each other. That price was arrived at by taking the value as of the date of consolidation of the combined assets of the consolidated corporations." [Findings, Tr. p. 214.]

It is plain from Mr. Gaylord's testimony concerning figures used in computing the division between the respective stockholders of the Carton Company and the Printing Company of the stock issued by the new company that $100 per share was not a price fixed but only the par value of the new company's stock. Par value of stock given for something is no evidence of value of that thing.

> *Ziegler*, 1 B. T. A. 186, Dec. 78.

The foregoing remarks are applicable to the Tax Court's comment that

> "Clinedinst had more at stake in the two corporations than Gaylord, and yet he was willing to deal on the basis of value of assets, which gave an indicated value for the stock of the new corporation of $100 per share." [Findings, Tr. p. 215.]

Though Clinedinst's Menasha Printing Company may have been worth more than the Menasha Carton Company in which Mr. Gaylord was interested, it was Clinedinst who, as the Tax Court found,

> "desired to consolidate the assets and businesses of the two corporations into a new corporation, with Gaylord, as its manager." [Findings, Tr. pp. 206 to 207.]

in accordance with Mr. Gaylord's testimony

> "that Mr. Clinedinst was satisfied that I was the man to run the business" [Tr. p. 369]

and, consequently, it was Mr. Gaylord who dictated the terms of the consolidation. Clinedinst was quite willing to use the measuring stick of "quick assets" plus appraised value of tangible assets in arriving at the proposed dis-

tribution of the stock of the new company because he was thereby obtaining Mr. Gaylord's managerial ability and services for the printing business combined with the Carton Company.

The Tax Court acted arbitrarily in disregarding the unimpeached and uncontradicted evidence of Mr. Gaylord as to earnings of the Carton Company and the Printing Company and of the combination resulting therefrom. No attempt was made by respondent, by cross-examination or otherwise, to disparage this testimony. While Mr. Gaylord testified from memory and in what he called "round figures", he was one of the men who had been vitally interested in the transactions involved, and there is nothing extraordinary in the circumstance that he exhibited such a good memory for figures in what had then taken place.

However, it must not be overlooked that for years before the hearing before the Tax Court in these proceedings Mr. Gaylord had furnished to the Treasury Department a statement of the earnings of the Menasha Carton Company and the Menasha Printing Company and of the consolidated Menasha Printing and Carton Company for the period 1915 to 1919, which statement appears in Exhibit G to the petitioners' respective petitions to the Board of Tax Appeals [Tr. pp. 93 to 94, 183 to 184] and that Mr. Gaylord, as already pointed out, testified to the truth of the statements contained in such exhibits.

The Tax Court also appears in its Findings and Opinion on the subject of the basis for computing gain on sale of the Marathon Paper Mills stock, to follow, despite Mr. Gaylord's undisputed testimony to the contrary, respondent's theory, hereinbefore referred to, that there were two

separate transactions and not simply one undivided and integral transaction involved in Mr. Gaylord's surrender of his 337 shares of Carton Company stock and his execution of the promissory note, for which together, considered as a whole, he received the 1975 shares of common and 410 shares of preferred stock of the new company. Neither respondent nor the court had the right to make such a severance of the contract to which Mr. Gaylord was a party in providing for the consolidation of the Printing Company and the Carton Company.

First Seattle Dexter Horton National Bank et al v. Commissioner (C. C. A. 9, 1935), 77 Fed. (2d) 45.

In determining fair market value of the common stock of Menasha Printing and Carton Company, acquired by Mr. Gaylord in the 1917 consolidation, consideration must be given to the then value as going concerns of the two companies and businesses so merged, which going concern value involves earnings and the result of the capitalization thereof.

Pfleghar Hardware Specialty Co. v. Blair (C. C. A. 2, 1929), 30 Fed. 614;
White & Wells Co. v. Commissioner (C. C. A. 2, 1931), 50 Fed. (2d) 120;
Jamieson v. U. S. (D. C., D. Mass. 1935), 10 Fed. Supp. 321;
Cushing v. U. S. (D. C., D. Mass., 1937), 18 Fed. Supp. 83.

Demonstrated earning power of stock must be considered.

O'Bryan Bros. v. Commissioner (C. C. A. 6, 1942), 127 Fed. (2d) 645;
Morrill v. U. S. (D. C., D. New Hampshire 1937), 18 Fed. Supp. 697.

VI.

The Tax Court Erred in Failing to Find and Decide That Under Section 202(a) of the 1926 Revenue Act the Cost to Mr. Gaylord of the 352 Shares of Menasha Printing and Carton Company Stock Received by Him From His Brother C. W. Gaylord in 1927 in Exchange for 432 Shares of Robert Gaylord, Inc., was the Fair Market Value of Such Shares of Menasha Printing and Carton Company in August of 1927.

Though, as found by the court, the whole arrangements whereby Mr. Gaylord acquired from his brother C. W. Gaylord in 1925 432 shares of Robert Gaylord, Inc. in exchange for 350 shares of Menasha Printing and Carton Company stock, was, as between them, cancelled, as though it had never existed [Findings, Tr. pp. 209 to 210] the transaction was, nevertheless, taxable under the then applicable law regardless of the fact that the parties thereto did not at the time so consider it. The value in August, 1927, of the 352 (not 350) shares of Menasha Printing and Carton Company stock so received by Mr. Gaylord from his brother upon return to the latter of the 432 shares of Robert Gaylord, Inc. was as shown in Exhibit H to the petitioners' respective petitions to the Board of Tax Appeals [Tr. pp. 96, 186], to the correctness of which Mr. Gaylord testified without contradiction, $2,762.51. After briefly finding the facts as to this transaction, the court completely ignored it, as indicated by its subsequent silence on the subject on its Findings and Opinion.

It is respectfully urged that the decisions of the Tax Court of the United States under review be reversed.

Respectfully submitted,

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